



Domestic Determinants and Security Policy-Making in East Asia

Edited by
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Colloquium on International Security
November 2000



**Asia-Pacific Center
for Security Studies
(USA)**



**National Institute
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Preface

This publication, entitled *Domestic Determinants and Security Policy-Making in East Asia* is a result of cooperation between the National Institute for Defense Studies (NIDS) in Tokyo and the Asia-Pacific Center for Security Studies (APCSS) in Honolulu. The papers collected here were presented at the “Colloquium on International Security” held in Tokyo from November 15-16, 2000 and hosted by NIDS. This theme also was the focus of the Asia-Pacific Center for Security Studies’ Directed Research Program in 2000-2001. An earlier draft of Mr. Yasuhiro Matsuda’s paper was completed while he was a Visiting Research Fellow at APCSS. Dr. Kyong-wook Shim’s paper was published separately as an APCSS Occasional Paper in October 2000.

Though it has long been conventional wisdom that foreign and security policies have domestic “drivers,” the emphasis on this approach to understanding a country’s policies has increased with the end of the Cold War. One reason is that the breakdown of the bipolar international order has allowed more margin of maneuver for countries to determine their own foreign and security policies. Second, there has been a wider conception of security challenges, not focused entirely on traditional, geopolitical issues. The broadening conception of security challenges has necessarily engaged a wider array of actors and interests, including within countries. And third, the growth of civil societies, increased availability of

information, and globalization have impinged upon security policy in conception and articulation. It is the hope of NIDS, APCSS, and the editors that these papers will contribute to a dialogue aimed at achieving a better understanding of one another's true security concerns and intentions.

Aside from bringing together a number of distinguished participants from East Asia, this effort had a particularly unique feature. Paper presenters were asked to speak to the domestic determinants of security policy of a country other than their own. The goal of this approach was to enhance the participants' appreciation of how other countries perceived their countries.

We are grateful to the authors for their efforts and to NIDS and APCSS for making our first collaborative effort a success.

August 2001

Satu P. Limaye
Yasuhiro Matsuda

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Prospects for Security in the Asia-Pacific Region 2000 - 2010

H.C. Stackpole

Overview

There has been a great deal of discussion since the advent of the Asian financial crisis in 1997 about managing change in the strategic landscape of the Asia-Pacific region. One of the fundamental factors in both the financial meltdown and the challenge to traditional security practices has been globalization. The engine that has generated globalization has been the information technology (IT) revolution that has marked the post-Cold War decade of the 1990s and has reached a new zenith entering the 21st century. Curiously, while this brave new world of IT has crashed upon us like a tsunami, it has resulted in better international communications and reduced the likelihood of traditional warfare between nations and all but eliminated classic set piece battles of corps and divisions, ocean battle fleets and air armadas. What has happened at the other end of the spectrum due to this same globalized information technology revolution, however, has been the stripping away of the veneer of civil behavior and reconciliation from tribal, ethnic, and religious enmities

resulting in communal killing from the Balkans to Africa to South Asia. This is a new “ring of fire” (having nothing to do with seismic activity and tectonic plates) across the southern tier of Asia. Hate, distrust, and terrorism have been manifest from Sri Lanka and the Indian Ocean down the Indonesian archipelago through Mindanao and the Solomon Islands to Fiji. In fact, according to the London-based International Institute of Strategic Studies, 100,000 people have died in armed conflicts in the past year. Small wars and civil unrest have resulted in brutal killings throughout the world. In South Asia, along the line of Control in Kashmir, indiscriminate artillery exchanges have caused the death of more than 5,000 civilians with the toll rising weekly. The flip side of that coin in terms of human misery is found in the usage of modern technology to further transnational criminal activity on a grand scale that no one nation on its own can hope to defeat or even blunt. It is an all too familiar laundry list of the violation of human security and perpetual degradation of our neighbors both subregionally and worldwide.

Threat

The “threat” of today carries a myriad of names, but all are a challenge to comprehensive security that goes beyond defending the territorial integrity of our respective homelands and the protection of our people, normally defined as external and internal security. Arms trafficking, terrorism, illegal migration, organized crime with money laundering, and drug trafficking contribute significantly to the need for crisis management that eludes civil law enforcement agencies. These circumstances, coupled with the ravages of nature by volcano, typhoon, flood, and earthquake, create a formidable challenge to human security globally and regionally. My remarks are concerned with a sub-regional approach to dealing with these causes of conflict that comprise essentially a non-war-fighting security threat, but does not preclude low-intensity conflict. It is here, I believe, that the prospects for a common agenda and a defusing of major war outbreaks combine for the common interest of the nations of Asia.

View of the U.S.

The United States is inescapably an Asia-Pacific nation because it is a maritime nation. It has engaged in three wars in Asia in the last century in order to allow a peaceful, stable Asia-Pacific region to emerge from oppression and totalitarianism. The United States, despite this payment in blood, continues to suffer from a poor image among many Asians. Arrogance is the term most often used. There is also a streak of isolationism in the American makeup that emerges briefly from time to time, and, in my opinion, is misread beyond U.S. shores. The truth is that America is a “reluctant” superpower faced with realities that mandate a new approach to security matters. Certainly forward-based U.S. Forces in Japan and the Republic of Korea are facing political and public attitudinal challenges at a new fundamental level.

Globalization

The central theme of discussion, that has dominated all the deliberations of the Fellows at the Asia-Pacific Center for Security Studies has been the friction between globalization and nationalism. Is globalization a threat to sovereignty? It is useful to identify the consensus core characteristics of globalization as a common frame of reference:

- Unprecedented economic interdependence driven by cross-border capital movements, rapid technology transfer, and “real time” communication and information flows.
- Rise of new actors that challenge state authority, particularly non-governmental organizations and civic groups, global firms and production networks, and even financial markets.
- Growing pressure of states to conform to new international standards of governance, particularly in the areas of transparency and accountability.

- The emergence of an increasingly Western-dominated international culture, a trend which in many countries has raised concern about the erosion of national identity and traditional values.
- The rise of severe transnational problems which require multilateral cooperation to resolve.

The security impact of these core elements of globalization are increasingly complex. On the one hand, there is a positive impact: Economic integration has reduced the potential for conflict, mainly in Southeast Asia. However, it has also given rise to new security concerns and aggravated existing tensions in both intra- and inter-state behavior. The relentless force of globalization grows against a backdrop of new transnational threats, a perception of weakening regional institutions (APEC, ASEAN), shifts in balance of power, and, most importantly, expanding military roles despite declining resources and recruitment shortfalls.

U.S. and Japan

While the importance of the U.S.-Japan alliance cannot be overstated as a foundation stone of Asia's stability, the bilateral relationship has been subjected to heavy stress. Managing the U.S.-Japan relationship is crucial and impacts China policy for both countries. This conference is an example of determining how best to achieve a positive outcome. Factors that dominate the relationship in 2000 are:

- **Bureaucratic pursuit of narrow interests** — With the alliance's purpose unclear, even with the new guidelines, government agencies are free to pursue narrow goals. In both countries, several agencies are vying for control of policy. This results in an accumulation of "mini policies," often uncoordinated and also appearing in some cases as contradictory.
- **Compartmentalization of issues** — In an environment of policy parochialism, agencies with the "lead" on a given issue often closely guard control of decision making. Issues that necessitate a broad-

based inter-agency response, such as the Asian financial crisis, are addressed by only a single department or ministry.

- ***American neglect and Japanese obsession*** — With the purpose of the alliance requiring clarity in the absence of a Cold War threat, Washington has sometimes neglected relations with Japan. Tokyo, concerned with the same requirement for a new rationale, fears weakening of American resolve to remain committed. Security independence by Japan and U.S. abandonment of the alliance equate to some of the worst fears of other Asian nations.
- ***Divergent interests and perspectives*** — The Cold War, to a degree, was a unifier of common interest in the alliance and on major international issues. That model has changed and the interplay of diplomacy, economics, and regional security demands a new approach if the alliance is to remain viable.

China

China is modernizing the People's Liberation Army to the extent its defense budget will allow as indicated by the PRC White Paper on National Defense in 2000. U.S. national missile defense and theater missile defense have been major concerns of China and factors in renewed ties with Russia and India. However, China's internal problems are also challenges to stability. The difficulties facing China's leadership today include:

- State-Owned Enterprises (SOE) divestiture
- Rising unemployment in rural and urban areas
- Massive internal migration
- Shrinking foreign direct investment (FDI)
- Corruption
- Shifting of power from the center to the provinces

- Poor regulation of the banking and financial system
- Bad debt currently held by State-Owned Enterprises
- Growing political dissent
- A host of environmental challenges
- Ethnic tensions, including Muslim separatism

China's assessment of the security situation in the "White Paper" is startling in its parallel with a variety of U.S. assessments from both government and private "think tank" analyses. "Peace and development" do remain as the major themes in the world of 2000. There is a trend toward multi-polarity and, of course, economic globalization with efforts at relaxation in the international security situation at least in the macro sense generally, and in the Asian major flash points of the Korean Peninsula, Taiwan Strait, and South Asia specifically. They see no major war and expect the forces of peace to prevail. China does, however, recognize that there has been no significant "peace dividend" following the end of the Cold War and the paper enumerates the negative factors, which I am certain given the design and nature of this conference, will be discussed in detail.

Views of the U.S. from Asia

The United States, in developing a new model for its Asian security policy, must be more acutely aware of perceptions of America by Asians. U.S. actions in the Balkans, while carried out with the best of motivations, have nonetheless left serious concerns among Asian nations about U.S. objectives and policies. Kosovo has left the impression that (1) the United States will intervene unilaterally anywhere, anytime without benefit of international approval and (2) will always employ "hi-tech" warfare in the interest of force protection. The circumstances in Kosovo were unique and not likely to be repeated. However, the accidental bombing on the Chinese

Embassy in Belgrade does not convince many that the most powerful, technically capable nation in the world could make a mistake. The Chinese “man in the street” comes to one conclusion: the attack was deliberate. These actions have fueled the Asian views we at the Asia-Pacific Center for Security Studies have heard from our Fellows and in the travels of our faculty and researchers throughout the region this past year. Allow me to share some of those views.

Korea's Perceptions of the U.S.

- According to contemporary Korean thought driven by a neo-Confucian view of the world, the United States positions itself as a senior partner but does not show the benevolence, understanding, tolerance, or genuine caring attitude that is the “older brother” responsibility. This makes the United States undeserving of respect.
- Koreans’ view of the United States is affected by the memory of negative events attributed to the United States. They range from the Kwangju incident to the current No Gun Ri alleged massacre, the economic crisis, and the occasional crime committed by military personnel.
- Americans are overly proud and arrogant. They do not listen and do not return equal respect.
- Americans are naïve and gullible. They are poor bargainers who often cannot see things at true value.
- America is decadent and does not retain or pass on good manners. Americanization and Westernization are considered the same and are a cultural compromise and bad influence on Korea.

While all Koreans see some good to relations with the United States, they see negative impacts that are weighty to a people who cherish sovereignty and self-determination and have traditionally looked unfavorably on intrusive internationalism.

China's Perceptions of the U.S.

- Many Chinese view the United States as hegemonic, domineering, and arrogant with the intent of preventing the “rise of China.” There is a view that the true U.S. goal is to re-impose some form of colonialism on China and gain access to cheap labor and mass markets.
- The PLA leadership respects U.S. technological and military prowess but is not afraid of it either. Many Chinese believe the United States will run at the first sign of blood; a view reinforced by the force protection approach employed by the United States in Kosovo.
- The U.S. focus on human rights is (1) primarily a political strategy designed to aid in the suppression of China or (2) an arrogant, intolerant interpretation of what human rights are that results in flagrant interference in Chinese affairs. The United States is insensitive to the progress China has made in this arena and to the grave dangers posed to Chinese society by the potential loss of control resulting in chaos.
- The American people, however, are seen in a generally favorable light. It is the government that is the problem. The view is that most Americans see good relations with China (preferably a weak China) as in the U.S. interest.

Japan's Perceptions of the U.S.

- Most Japanese still support the U.S.-Japan security treaty, but that support is somewhat soft and often contradictory. For example, a record number of Japanese want to see the alliance maintained, but solid majorities also would like to see U.S. forces reduced and consolidated. They also would like to pay less to host U.S. bases.
- At the same time, there is considerable fear in Japan of an American turn inward. Many Japanese see the United States as increasingly inclined to relax on its wealth and less interested in events overseas.

Some Japanese see U.S. pursuit of NMD as indicative of this lingering “isolationist” sentiment, and worry about a “decoupling” of the United States from Asia.

- Perhaps in apparent contradiction, many Japanese are also very concerned about the future of U.S.-China relations. As has been the case for much of the post-war period, many Japanese are afraid of being entangled in America’s wars; worry that Sino-U.S. relations might spiral into confrontation is the latest manifestation of this fear. Tokyo would be very concerned if U.S.-China relations went into serious decline.
- Finally, Japan wants to find more diplomatic “space” for itself in international affairs. It is tired of perpetually being under the American wing. The Asian Monetary Fund proposal was one example of this, as is Japan’s ineffective attempt to be a mediator in the Kashmir dispute between India and Pakistan. Japan wants to be more of a leader, particularly in Asia, but continues to struggle with how to become a leader.

In the interests of time, suffice it to say other nations such as Russia, Indonesia, Pakistan, and India perceive an arrogant, highhanded, and meddling U.S. approach to them as these nations struggle with resolving grave issues internally and with their neighbors. Our concentration is of necessity on Northeast Asia. It is in this context that I will conclude with some thoughts on multilateral approaches to security in the region.

Prospects for Multilateral Regional Security Enhancement

A wide variety of individuals and organizations in recent days have advocated a multilateral approach to security in Asia with no intention of creating a NATO-like organization. Rather, the emphasis has been on “enriching” bilateral relations to expand to a comprehensive security approach encompassing the areas of common interest identified at the start of my remarks as non-war-fighting; humanitarian assistance, disaster relief,

peacemaking and peacekeeping as principal areas of multilateral operations. At the Chiefs of Defense Conference held at the beginning of this month in Honolulu, seventeen nations of the region agreed to proceed on developing tactics, techniques and procedures (TT&P) essential to working together. Also agreed to were continuing workshops in the refinement of the Multilateral Planning and Assistance Team (MPAT) as the catalyst for forming a joint combined staff for response to crisis in the region. These coalitions would be brought together by mutual agreement. East Timor is but one example of such coalitions, but it is only one model; not *the* model.

Multilateral efforts are in and of themselves' confidence-building measures in the region. Japan and the United States are in the unique position of being the building blocks for a Northeast Asia dialogue effort resulting in a sub-regional multinational response capability. Dr. James Auer of Vanderbilt University, in his recent analysis for the U.S. National Defense University sees the U.S.-Japanese partnership as essential to a multilateral approach in the region. The paper itself, written by a team led by Mr. Richard Armitage and Dr. Joseph Nye (well known to you here), clearly spells out the need for "full Japanese participation in peace keeping and humanitarian missions and removal of self imposed restraints that would otherwise burden other peace keeping nations." It also states a plea for "development of a U.S.-Japan force structure characterized by mobility, flexibility, diversity and survivability to reflect the regional security environment."

The seeds of a multilateral approach can be found in the PRC White Paper on National Defense 2000. The section on "Regional Security Cooperation" specifically lauds the Asean Regional Forum (ARF) as the only pan-Asia-Pacific official multilateral security dialogue and cooperation forum at present. It goes on to speak of the necessity to "focus on confidence building measures, explore new security concepts and methods and discuss the question of preventive diplomacy."

Dr. Wu Xinbo, a Professor of International Politics at Fudan University in Shanghai, in an article for Pacific Forum/CSIS states: "The establishment of an Asia-Pacific security community is possible because states in the region have shared interests in a peaceful and stable security

environment, because they increasingly benefit from growing economic interactions. This nascent mechanism for regional security will evolve over time into a more effective means for promoting regional cooperation on security issues. In this context, the United States will play a significant role, not as a hegemon, but as a key player.”

Professor Mike Mochizuki of George Washington University’s Elliot School of International Affairs, in a September 2000 article, calls for multilaterizing the U.S. alliance network because of the need to end the Cold War era. He says “the United States should try to create an inclusive regional security community based on the concept of cooperative security. If military forces work together on joint missions, it increases transparency and trust. Even if there are major conflicts of interest, there is enough trust that these crises can be managed without the use of military means.” He then proposes a formalized North Pacific security dialogue to deal with common transnational problems. The proposal would include as members, the US, Japan, China, Russia, both Koreas, Canada, and Mongolia in a complementary organization to the ASEAN Regional Forum.

There are many more similar commentaries I could cite. However, I believe the multilateral approach in a time of strategic change is the key to non-threatening enhanced regional cooperation in the first decade of the 21st century. Finally, one certainty is that the role of military power has changed significantly over the span of history since the nation-state first appropriated it. Cooperation and integration of capabilities among states has become the norm. Other dimensions of national power have become increasingly important in the development of national security strategies. Yet, the threat of force inherent in the traditional roles of the military (i.e. deterrence, compellence and defense) remains as a foundation for interaction within the international system. As we move into this new decade, military power can be most effective in helping maintain stability through enhancing transparency and strengthening cooperative approaches that seek to include and accommodate the concerns and interests of others in the region rather than emphasizing narrowly conceived unilateral interests.

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Changing Japanese Attitudes Toward Security

John H. Miller

During the 1990s, Japan began to move away from the pacifist-isolationist consensus which dominated its approach to security matters during the Cold War era. Major milestones in this process include: the beginning (in 1992) of Japanese Self Defense Force (SDF) participation in UN peace-keeping operations; the 1996 U.S.-Japan Joint Security Declaration outlining an agenda for expanded bilateral cooperation, including an enlarged Japanese military role in regional contingencies; and the inauguration in early 2000 of a Japanese parliamentary body to study revision of the nation's "Peace Constitution."

What is behind these developments and what do they portend for Japan and its relations with its Asian neighbors and the United States? Do they foreshadow a revival of the militarism and ultranationalism of the 1930s? Or do they reflect a growing desire to become a "normal country" in the sense of playing a more active and independent political-military role?¹

1 Diverging academic views on these questions are surveyed by Michael J. Green, "State of the Field Report: Research on Japanese Security Policy," National Bureau of Asian Research, AccessAsia Review, Vol. 2, No.1, September 1998.

The Postwar Consensus

A useful starting point for considering these questions is the nature of the “postwar consensus” referred to above. Until the 1970s, of course, no such consensus existed. During the 1950s and 1960s the nation was polarized by a bitter left-right ideological confrontation over security issues and Japan’s proper role in the world. The left, represented by the Japan Socialist Party (JSP) and grounding itself on the “no-war” clause (Article 9) of the postwar constitution, advocated a posture of unarmed neutrality in the Cold War and the pursuit of pacifist ideals. The right, led by the Liberal Democratic Party (LDP), favored alignment with the U.S. in the Cold War and limited rearmament to complement the American security guarantee provided under the U.S.-Japan Mutual Security Treaty.

The LDP ultimately prevailed in this confrontation, but only by largely co-opting the views of the left.² Under the LDP’s compromise formula — sometimes known as the Yoshida Doctrine after its architect, Prime Minister Yoshida Shigeru — Japan was defined as a unique “peace state” dedicated to realizing the pacifist ideals of its constitution. The security treaty with the U.S. was upheld, but it was considered to require few obligations on Japan’s part other than the provision of bases for American military forces and diplomatic support of U.S. policies. The rebuilding of Japan’s military forces was likewise affirmed, but only to the extent necessary to assure a modest self-defense capability. There were four important corollaries of the Yoshida Doctrine: “Japan would not dispatch its Self-Defense Force abroad to be part of collective defense schemes; Japan would not become a nuclear power; Japan would not export arms; and Japan would limit its defense spending to 1 percent of GNP.”³

During the 1970s and 1980s the Yoshida Doctrine attracted broad public and elite support, becoming, in effect, Japan’s reigning orthodoxy. A number of factors help to explain this development. First, it enabled the nation to

2 John Dower, “Peace and Democracy in Two Systems: External Policy and Internal Conflict,” in Andrew Gordon, ed., *Postwar Japan as History* (Berkeley: University of California Press, 1993), pp. 22-5.

3 Kenneth Pyle, *The Making of Modern Japan* (Lexington: Heath, 1996), p. 239.

channel its energies and resources into the pursuit of economic growth and material prosperity. Second, it catered to the isolationist proclivities of the Japanese people by permitting them to disassociate themselves from international power politics and the military dimension of international security. Third, its “peace state” ideal appealed to Japanese nationalism by encouraging the celebration of Japan’s uniqueness and superiority. Fourth, it meshed with the perception of most Japanese that their country faced no serious external security threat. Finally, it reassured those at home and abroad who feared that Japan might again become an aggressive military power.

In the eyes of its critics, the Yoshida Doctrine’s principal shortcoming was its prescription of a passive and dependent posture in political-military affairs. Nationalists saw this as an affront to Japan’s dignity, while internationalists worried that it prevented Japan from playing a responsible leadership role. Perhaps the most interesting critic was former prime minister Nakasone who represented both camps. During his 1982-87 tenure as prime minister, Nakasone attempted to loosen the Yoshida Doctrine’s constraints. Thus, the 1 percent of GDP cap on defense spending was breached, the ban on weapons exports was relaxed, and the SDF’s responsibilities were expanded to include patrolling Japan’s sea-lanes up to 1,000 miles from its shores. However, other elements of the Yoshida Doctrine were maintained. Resistance to change came not just from the JSP (which continued to espouse unarmed neutrality) but also from the LDP, the bureaucracy, the media, and other power centers. The general public, while intrigued by Nakasone’s rhetoric, was also unwilling to countenance fundamental departures from the status quo. Japan thus entered the post-Cold War era largely unprepared to assume larger security responsibilities.⁴

Post-Cold War Changes

The difficulties which this unpreparedness posed for Japan were dramatically underscored by the 1990-91 Gulf Crisis. U.S. and allied requests that

4 Nakasone’s “limited success” is described by Kenneth Pyle, *The Japanese Question: Power and Purpose in a New Era* (Washington, D.C.: AEI Press, 1996), pp. 103-4.

Japan contribute military personnel as well as money and equipment to the coalition effort threw the LDP-dominated political system into turmoil. Few saw the crisis as posing a serious threat to Japanese interests, much less one that justified setting aside the Yoshida Doctrine's stricture against the overseas deployment of the SDF.

Under intense and unrelenting U.S. pressure, Japan in the end provided a substantial financial contribution (\$13 billion). But LDP-sponsored legislation which would have authorized the dispatch of noncombatant SDF personnel to the Gulf in support of coalition forces died in the Diet for lack of support. Rather than earning praise for their financial generosity and principled stand against participating in the war, many Japanese were surprised and mortified to find themselves assailed by derisive international criticism of their reliance on "checkbook diplomacy."

Sensitivity to this foreign criticism gave opponents of the Yoshida Doctrine political leverage to secure enactment in 1992 of the UN Peacekeeping Operations Cooperation Law authorizing SDF participation in UN peacekeeping operations. While this legislation undoubtedly reflects an important shift in Japanese thinking, pacifist and legal concerns resulted in a variety of restrictions designed to minimize the exposure of SDF peacekeepers to situations in which they might be obliged to use force even in self-defense. For example, the Law made SDF participation conditional on the opposing sides' agreement to a cease-fire, their acceptance of the deployment of the peacekeeping force, and their recognition of the neutrality of that force.⁵ One might suggest, moreover, that public support for SDF involvement in UN peacekeeping operations was inspired as much by hopes of restoring Japan's tarnished prestige in the international community as by any newfound sense of its responsibility to contribute more actively to international security.

The Gulf Crisis also gave impetus to a significant broadening of Japan's military responsibilities under the U.S.-Japan alliance to include logistical

5 Peter J. Katzenstein and Nobuo Okawara, "Japanese Security Issues," in Craig C. Garby and Mary Brown Bullock, eds., *Japan: A New Kind of Superpower?* (Washington, D.C.: The Woodrow Wilson Center Press, 1994), p. 61.

and other support to U.S. forces responding to regional contingencies “in the areas surrounding Japan which will have an important influence on the peace and security of Japan.” This undertaking, which was formally announced at the April 1996 Clinton-Hashimoto summit, sprang primarily from concern in both Tokyo and Washington that the alliance might not survive a repetition of the Gulf Crisis, particularly if it involved a military conflict near Japan in which U.S. forces sustained heavy casualties while the SDF again sat on its hands. This concern was heightened in 1994 by the inability of Japan to provide assurances of operational assistance in the event of a U.S. conflict with North Korea over the latter’s nuclear program. As noted by Mike Mochizuki, “only by (providing such assistance) could Japan check the isolationist tendencies in the United States.”⁶

As elaborated in the 1997 U.S-Japan Guidelines for Defense Cooperation, Japan’s willingness to cooperate militarily with the U.S. in promoting regional security represents another “breakthrough” in Japanese security thinking. Although publicly presented as merely an extension of the Yoshida Doctrine’s “exclusive defense-oriented” posture, it moves Japan close to de facto participation in collective security. Broad acceptance in Japan of this move — unthinkable in the 1970s or even the 1980s — reflects the erosion of the complacency with which Japanese viewed their external security. Key factors in this shift included North Korea’s nuclear weapons program and missile testing, and China’s military buildup, its continued nuclear testing, its assertive claims over the Senkaku islands, and its use of “missile diplomacy” to try to intimidate Taipei in the 1995-96 Taiwan Straits crisis.

Perhaps the most traumatic external shock of the decade was North Korea’s firing of a ballistic missile over northern Japan in August 1998 which brought home to Japanese for the first time since 1945 their vulnerability to military attack. In response to the public outcry over this incident, Japan decided to proceed with long-discussed plans for joint research with the U.S. on ballistic missile defense and the development of

6 Mike M. Mochizuki, ed., *Toward a True Alliance: Restructuring U.S.-Japan Security Relations* (Washington, D.C.: Brookings Institution Press, 1997), p.14.

an independent satellite surveillance system to provide early warning of missile launches. Also in reaction to the missile furor — and to public alarm over the March 1999 interception of North Korean spy boats in Japanese waters — the Diet overcame its inter-party squabbling and passed legislation implementing the U.S.-Japan Guidelines on Defense Cooperation.

The heightened security concerns inspired by North Korean provocations provided critics of the Yoshida Doctrine with the public and political support they had long sought for putting revision of Japan's Peace Constitution on the table. In July 1999 the Diet established a non-partisan committee to study this issue, which began public hearings in January 2000. The hearings are expected to last five years and to focus on Article 9's renunciation of military force, which forms the constitutional basis of postwar Japanese pacifism. It should be noted, however, that while there is broad support for changing Article 9, there is no consensus yet on how it should be changed.⁷ Moreover, few in Japan seem to be in a hurry to sort out this question. Some lawmakers, among them Nakasone, hope the constitution can be formally revised within five years after the completion of the committee's work — in other words, within a decade.

The Problem of Japanese Nationalism

The shift in Japanese security thinking during the 1990s described above was driven mainly by external changes, particularly increased Chinese and North Korean bellicosity. It was, however, facilitated by several domestic developments. First, the collapse of the left-right axis of Japanese politics and the JSP's jettisoning of its longstanding advocacy of unarmed neutrality weakened the influence of old-school pacifism. Second, the rise of Japan's postwar Baby Boom generation to leadership positions created a climate of opinion more receptive to confronting postwar taboos regarding the use of military force. Third, growing political nationalism disposed more Japanese

7 For an analysis of some of these views, see Kiyoshi Sugawa, "Time to Pop the Cork: Three Scenarios to Refine Japanese Use of Force," Brookings Institution, Center for Northeast Asian Policy Studies, July 2000.

than heretofore to regard the use of such force as a legitimate and even necessary means of upholding the nation's dignity and integrity.

Signs of a more nationalistic outlook abound in contemporary Japan. It is reflected, for example, in the popularity of the 1999 film "Pride" which glorifies Japan's wartime leader Hideki Tojo; the April 1999 election of outspoken right-wing nationalist Shintaro Ishihara as governor of Tokyo; and the Diet's August 1999 decision to accord official recognition to the nation's national flag and anthem, both of which have long been viewed by leftists as symbols of prewar ultranationalism and militarism. The linkage of this nationalism with an increased willingness to contemplate the use of military force was underscored by public approval of the firing of warning shots by Japanese destroyers during the North Korean spy boat incident — "the first fired in anger by the Japanese navy since the Second World War."⁸

Many observers, both within and outside Japan, regard rising popular nationalism and lessening inhibitions against the use of military force as troubling and even ominous developments. One reason for their concern is what Kenneth Pyle calls the "indelible image" of Japanese as a people who are predisposed by their history and culture toward militarist excesses.⁹ This image seems to stem largely from Japan's empire-building in Asia during the 1930s and 1940s and from the behavior of its troops on Pacific War battlefields. Whatever its origins, however, it assumes that Japan can never be a "normal" country with respect to military force. Thus, any Japanese moves to play a larger security role are — as was once suggested by former Singapore prime minister Lee Kuan Yew — akin to a reformed alcoholic consuming chocolate liqueurs.

There is no lack of evidence to support the latter interpretation of Japanese character and intentions. Prominent right-wing nationalists like Ishihara regularly issue provocative statements expressing approval of prewar emperor-centered nationalism, denial that wartime atrocities such as the Rape of Nanking occurred, and esteem for Japan's pre-1945 colonial and imperialist ventures in Asia. As is suggested by Prime

8 Michael J. Green, "The Forgotten Player," *The National Interest* (Summer, 2000), p. 42.

9 Pyle, *The Japanese Question*, p.8.

Minister Mori's reported statement last May that Japan is a "divine country with an emperor at the center," such notions are not confined to extremists. Furthermore, mainstream adherents of the Yoshida Doctrine, not just left-wing pacifists, voice fears that lifting pacifist restraints will unleash an uncontrollable wave of chauvinist sentiment which will propel Japan back toward militarism and ultranationalism.

Although such fears may eventually prove justified, there are several reasons for supposing that they are overdrawn. First, in contrast to the situation in the 1930s, contemporary popular nationalism does not spring from rejection of the West, economic crisis, and political alienation. Rather, it assumes openness to the outside world, satisfaction with Japan's democracy, and confidence in its economy (although, given Japan's economic difficulties, less confidence than a decade ago.) More than anything else, contemporary nationalism reflects a reaffirmation of the importance of the state in upholding national values. This marks a significant change from the postwar situation when, even though Japanese did not cease being highly nationalistic, they recoiled from the state and its symbols. Japanese today arguably are becoming "normal" nationalists, not reverting to ultranationalism.¹⁰

The refocusing of Japanese nationalism on the state entails a more positive evaluation of its armed forces — including the pre-1945 Imperial army — in promoting national goals. There is no reason why this must be seen as a manifestation of some latent pathological impulse in the Japanese national character toward militarism. Pride in the military is a normal feature of nationalism in virtually all nation-states, and it does not necessarily connote militarism. Considered from this perspective, the rejection of all things military in postwar Japan was "eccentric" by international standards. True, the SDF gained broad acceptance, but given the perceived absence of a serious external threat and the numerous constraints on its use, it served no obvious purpose other than occasional disaster relief. Furthermore, the unwillingness of postwar Japanese to acknowledge that the SDF was a true "military" reflected their misgivings about its legitimacy.

10 Yoshiya Muto, "Japanese Security Orientation: A Psychological Aspect," unpublished paper, July 3, 2000.

Conclusions: Toward Normalcy

The slow revival of political nationalism and the evolution of more realistic attitudes toward external security challenges have undermined the consensus which supported the Yoshida Doctrine, and are leading Japan toward becoming a “normal country” in the way it perceives the use of military force to promote national security. One might reasonably anticipate that this process will eventually result in modifications to its “exclusively defense-oriented” posture, probably including the legitimization of Japanese participation in collective security arrangements and the lifting of restrictions on SDF participation in UN peacekeeping operations, which involve the use of force. However, sudden or radical departures from established policies — such as a surge in defense spending or the acquisition of power projection capabilities — are highly unlikely.

The latter assertion might appear to be belied by Japan’s reputation for abrupt changes in course, such as those, which followed its defeat in 1945, the Manchurian Incident in 1931, and the appearance of Commodore Perry’s Black Ships in 1853. However, each of these volte-faces was provoked by an external crisis which was seen to threaten the integrity if not survival of the nation. Absent such crises, modern Japanese history reveals a strong preference for evolutionary over revolutionary change, and an equally striking tendency to clothe change in the forms of tradition.¹¹ Since Japan faces no external crisis, it is reasonable to expect that these historical patterns will dominate the pace and direction of the “normalization” of its approach to national security.

One cannot, of course, be sure that Japan will not evolve, albeit incrementally, into a military great power. With the world’s third largest defense budget and a highly sophisticated industrial and technological base, it undoubtedly has the potential to do so. As previously noted, moreover, prominent political figures like Ishihara favor just such a course. Even if Ishihara does not represent mainstream attitudes at either the elite or mass level, these attitudes could change, particularly if there were a

11 Carol Gluck, “Themes in Japanese History,” in Ainslie T. Embree and Carol Gluck, eds., *Asia in Western and World History* (Armonk: M.E. Sharpe, 1997), pp. 731-50.

dramatic deterioration in Japan's external security environment. Japan's postwar pacifism is not necessarily immutable; indeed, as argued above, it is already beginning to break down. Viewed historically, furthermore, it might be seen as a somewhat aberrant interlude for a nation, which has been dominated, by military elites and values for centuries.

This being said, there are a number of constraints on Japan's "re-militarization." First, given the fact that Japan has not come to terms with its prewar aggression in Asia, any move by it to become a military great power would inspire alarm among its neighbors, particularly China and Korea which are deeply suspicious of Japanese intentions. Second, current budget deficits, coupled with the prospect of large future increases in welfare spending to meet the needs of Japan's rapidly aging population, will limit resources available for defense. Third, despite dissatisfaction with U.S. bases and interest in a larger SDF role, most Japanese oppose increased defense spending and support continued reliance on the American alliance.¹² Fourth, Japan's defense agency is a "weak sister" within the Japanese government, being dominated by the more powerful ministries of finance, foreign affairs, and international trade and industry. Fifth, the SDF remains a "quasi-military" which is hobbled by a host of legal and political restrictions, and which is still viewed with suspicion or indifference by many Japanese.

In the final analysis, the direction in which Japan moves will largely be determined by what it decides should be its proper international role and place. In the past, this has always meant fitting into "an existing world order with an already defined agenda." In the uncertain post-Cold War world, with its onrushing tide of globalization, resolving this question will not be easy for Japanese — or for the rest of us.¹³

12 See U.S. Department of State Opinion Analysis," Japanese Security Views Show Movement After Korean Summit," November 21, 2000.

13 Carol Gluck, "Japan and America," in Gluck and Embree, *op. cit.*, p. 808.

International Dynamics of the U.S. Military Budget

Yan Xuetong

After the demise of the Soviet Union, the United States became the only military superpower and now enjoys the best security situation since its independence. Despite this dramatic improvement in its security environment, the United States has adopted a very expensive defense policy. It picked up the Strategic Defense Initiative (SDI) idea raised by former president Reagan in the early 1980s to develop a national missile defense (NMD) while it improves its offensive weaponry. America spends roughly \$300 billion annually on its military. What drives U.S. policymakers to propose an increase in the defense budget? What are the potential threats that justify the current level of military spending? Has the American military revised its policy to deal with the new realities of the post-Cold War? Do policymakers misread the public's attitude toward defense spending? Since we cannot find appropriate external factors to explain why the United States continues its Cold War defense policy in the post-

Cold-War era, this paper tries to look into domestic factors for explanations. It is very obvious that America's current defense policy, including its NMD policy, is a result of the combination of several domestic factors. This paper tries to argue that four of them play important roles in American defense policy-making. They are political culture, congressional politics, the interests of the military itself and military industry, and elite monopoly of defense policy-making.

Political Culture

The Russians can no longer afford a superpower military. Russian military spending decreased to less than \$65 billion a year and they have cut their armed forces from 5 million to 1 million. Yet, the United States still keeps hundreds of thousands of troops stationed around the world. The Russians have not built new submarines; on the contrary, they have dry-docked most of their current fleet. Russia is regarded as a shadow of the former Soviet Union in terms of a threat to U.S. security. U.S. military policy has not yet reacted to the changes in the international climate. The United States continues to keep military spending at near-Cold War levels.

The United States now stands poised to dramatically increase military spending. The budget released by the Clinton Administration in February 2000 includes \$12 billion in additional funds for the Pentagon, the second successive year of military spending increases. Having come to power, the Bush Administration is inclined to add another US \$30 billion. While some of the additional funds are intended to attract and retain qualified personnel and ensure the readiness of the U.S. military, most of the new spending is for expensive weapons systems. As soon as George W. Bush came to power, his Administration planned to add more to the Pentagon's budget in the next few years. It is suggested to increase the defense budget to \$312 billion by 2002 and may reach \$340 billion by 2004. Yet even though military spending is going up, there are those in Congress, both Democrats and Republicans, who believe that the budget increase is not

sufficient. For example, while the Administration's Fiscal Year 2001 proposal reached the Pentagon's goal of \$60 billion in annual spending for new weapons, members of Congress felt that even this was not enough.

Examining the cultural base of a large military budget in the United States, we find that a belief in power plays a fundamental role. The paramount characteristic of American political culture is their belief in power. Over 200 years of history has educated Americans to believe that the world only takes orders from those who are powerful. With this political culture the U.S. government bases American security on military power. Although there is no real threat to American security after the Cold War, America still regards it as necessary to keep the strongest military in the world. The debate between policy-makers is not whether the United States should keep a stronger military than other countries, but how much stronger it should be. The moderate group argues for a military capability stronger than America's vital enemy and conservatives advocate a military stronger than the total combination of all American enemies. They even do not fully trust their allies. Therefore, paranoia drives American leaders to spend huge amounts of money on the military to enlarge the gap of military capability between the United States and the rest of the world. This political culture partly explains why the United States insists on national missile defense (NMD) even when that plan is opposed by its military allies.

After the Cold War, many American politicians argued that the U.S. military should play the role of world policeman. The role of a world policeman is based on the concept of protection of human rights. The concept of human security goes back to the United Nations Universal Declaration on Human Rights, which states: "Everyone has a right to a standard of living adequate for the health and well-being of himself and his family, including food, clothing, house, and medical care, and necessary social services. Everyone has a right to education." By focusing on the well-being of individuals, this new concept of security revises traditional notions of state sovereignty. The definition of national security and the use of military power have increasingly moved away from the

state-centered doctrine of the previous era. For the war in Kosovo, President Bill Clinton said: “We cannot simply watch as hundreds of thousands of people are brutalized, murdered, raped, forced from their homes, their family histories erased, all in the name of ethnic pride and purity.” The Bush Administration only differs from Clinton’s in which kind of humanitarian interventions to participate in rather than whether or not to be involved.

Some scholars are skeptical about using human security as a framework for future U.S. foreign policy decisions. Some people question the definition of “human security.” Does it mean there are certain crimes against humanity that the United States cannot tolerate and it will therefore send military forces to intervene? That was the alleged rationale for bombing Kosovo and Serbia. But then if that is the standard, why didn’t the United States do something in Rwanda? Why didn’t the United States do something earlier in Indonesia? This was not a secret. So far, the lack of consistency in deciding where to intervene has led to criticism that the concept of human security will not work as a framework for U.S. foreign policy. “Human security” so far has drawn the selective use of military power when it suits the interests of the United States. That is neither a law nor principle. It is the American government that picks and chooses where it decides to engage in war.

People may also doubt military power is the right tool to solve the problems of human security. Globalization has made the rich and poor closer to each other. The rich will not be able to live securely in such world forever for a variety of reasons. With military power alone a country will not be able to deal with the climate, corruption, drug trade, and diseases. Diseases are now coming across borders-drug-resistant TB, drug-resistant infections, malaria and other tropical diseases that move with climate change. We live in a world where health threats do not respect borders. As the leading power, the United States absolutely cannot ignore these security threats. It is clear that the U.S. needs to act cooperatively with the rest of the world rather than rely on its military equipment in the era of globalization.

The Orientation of Congress

After the Cold War, U.S. defense policy was criticized as unilateralist. Theoretically speaking, America's unilateral defense policy is mainly caused by its sole superpower position. But we cannot ignore the role of the political orientation of the legislature in American defense policy-making. The domination of neo-conservatism in the Congress and Senate has also pushed the American government to adopt a unilateral defense policy.

The neo-conservative shift from anti-communism to anti-authoritarianism did not change the basic strategy. That is to say, neo-conservatism stresses military containment of those countries that are regarded as American enemies and that military might is the base for protecting American strategic interests. The belief of neo-conservatism helped the Republicans gain advantage in both the House and Senate. This is not only indicated by the fact that the Republicans have more seats in these two legislative bodies but also by the fact that many Democratic congressmen and senators share neo-conservative views on security policy. Therefore, the House and Senate often attack the Clinton Administration in terms of security policy and require more military appropriations.

Between 1995 and 1997, Congress added more than \$21 billion in unrequested spending to the Pentagon's budget as members of Congress vied to fund their favorite programs. Money was added for the purchase of costly high-tech weapons, like the DDG-51 destroyer and the V-22 Osprey, and development of a national missile defense system. Special supplemental spending bills also provided money for operations in Bosnia and the Persian Gulf. September 1997 marked a turning point in the debate over increasing military spending. Responding to growing concerns in Congress about the readiness of some U.S. military units, President Clinton, for the first time, indicated his willingness to put more money into the Pentagon's regular budget request. Another area where Congress is requiring the military to spend more money is the U.S. nuclear arsenal. The United States currently spends at least \$25 billion annually to maintain and improve its nuclear capability. Under current congressional restrictions, the Pentagon cannot

reduce the current arsenal below the levels called for in the START I treaty. In terms of NMD, Republican legislators severely attacked Clinton's hesitation on deployment of this system and they pushed for increases of military expenditure. With the Bush Administration assuming office, the conservative force in Congress is ready to come to a consensus with the Administration on additional funding for NMD.

Theoretically, neo-conservatism believes that social Darwinism governs international relations. Therefore, Republicans never trust international norms and even advocate U.S. withdrawal from the ABM treaty. They are arguing that the ABM treaty is a piece of unreliable paper. Besides the conceptual explanation of why Congress pressed for a large military budget, there is another political reason. Congressmen have personal interests and want to give a political show to their constituents. Many members of Congress these days do not have any military experience. They do not want to be seen as soft on defense or opposing the military. This political game funds the increased American military budget and NMD and TMD projects. President Bush and Republicans in Congress are playing political games with U.S. national security and the American taxpayer's money by launching a new bidding war.

Interests of the Military and Military Industry

The interests of the military itself and the military industry can never be ignored when we discuss American defense policy. No matter what peaceful environment America enjoys, the U.S. military can always find an external threat to the United States. Without an external threat the military men will lose their jobs and incomes. An American said: "I think today in America much of the defense industry has become a jobs program. That is, we are spending money on defense not because we need to defend ourselves from vast enemies in the world. America is the only military superpower in the world. But we're spending it because we have not figured out what to do with these people who are working in the military sector."

U.S. weapons procurement policies are little affected by the changes of the world around the United States. For example, America has the finest fighter aircraft in the world, but the Pentagon is still considering the purchase of the F-22 “Raptor” at a cost of \$188 million per aircraft. Even though there is no new fighter aircraft rolling off any assembly line in American adversary or potential adversary countries, the Pentagon still argues that they need more advanced planes. As another example, the Navy is currently required to operate 18 Trident nuclear missile submarines. Deploying the additional four submarines costs the Navy \$500 million extra each year. The Pentagon spends almost \$400 million for 600 VIP aircraft to ferry their folks around; to take a helicopter instead of a 15-minute cab ride from Andrews Air Force Base to the Department of Defense.

In order to get more money from the government, the military never stops exaggerating external threats to American security. Although the United States has ratified the START II treaty, which reduces the number of strategic nuclear warheads deployed by the United States and Russia to 3,500 each, the Pentagon still wants to keep thousands of unneeded warheads. With the so-called external threats, the Pentagon argues that the United States must modernize its weapons systems in order to preserve the technological edge that served the United States so well in the Persian Gulf War. In fact, in some cases, perfectly good weapons systems are being taken out of service so that the military can afford to buy these costly new weapons. For example, nobody else in the world has a credible underwater fleet, yet the Pentagon has begun decommissioning “Los Angeles” class submarines, which remain the best in the world and have a lot of years of useful life. The Pentagon seeks to replace them with new “Virginia” class submarines at a cost of \$64 billion. Another weapon system retired before the end of its useful life is the Navy’s Ticonderoga class of cruisers, which are decapitated into razor blades to make room for additional purchases of the DDG-51 destroyer. And the Air Force plans to retire a portion of its fleet of F-15s, the premier fighter aircraft in the world, so it can afford to buy and operate its next generation fighter, the F-22.

The Cold War has been over for years, but the Pentagon still requires enough funding to fight two major wars nearly simultaneously. As soon as the Bush Administration considered revising the two-war doctrine, it brought about a serious debate in the Pentagon. Ivan Eland is the director of Defense Policy Studies at the Cato Institute, a public policy research organization located in Washington, D.C. He describes the budgetary implications of the Pentagon's requirement that the United States be able to fight two major wars without the assistance of allies. The real function of the two-war strategy is primarily used to justify the current force structure of the United States. The questions about the rationale behind the two-war strategy raise a very fundamental issue about one reason the Pentagon says it needs more money. According to Eland, it is the defense industry and members of Congress with major contractors in their districts that are providing the momentum for continued purchases of weapons designed to replace systems that are already the best of their kind or to meet a threat that does not exist.

The military industry is a strong supporter of the Pentagon's requirement for a large military budget. If there is a smaller military budget, the military industry will suffer the same as the military itself. In 1995, President Clinton issued Decision Directive 34, which outlined his administration's policy on weapons exports. In it, he urged Cabinet agencies to consider the economic benefit to American companies when deciding whether to grant a license for a military sale. The profit motive became a valid policy basis for selling weapons, and American diplomats were urged to find new markets for the U.S. weapons, just as they would do with any other products.

Since President Clinton took office, the size of the federal government has slowly decreased. But the number of federal workers engaged in promoting, financing, or otherwise facilitating weapons exports has increased from about 5,950 employees in 1993 to more than 6,300 in 1997. The largest single agency devoted to the arms trade is the Pentagon's Defense Security Assistance Agency (DSAA), where 5,900 personnel in 74 countries administer roughly \$12 billion annually in

weapons sales. Since DSAA receives most of its funding from a 3 percent charged to all major sales, the agency has a strong incentive to maintain, or even increase the current level of arms exports. To a great extent, it is by relying on the support from the defense industry that President Bush has won the presidency. Clearly, he has to repay the military industrial magnates. The economic interests of the defense industry are bound to be one of the main factors that the Bush Administration must take into account, because Bush will need their donations for the next election.

Much of the military funding which was a subsidy for the weapons industry appears in the U.S. federal budget under the heading of “Security Assistance.” Consuming more than \$6 billion per year, “Security Assistance” accounts for about half of America’s total budget for foreign operations. In fact, much of this money never really leaves the United States. “Security Assistance” is just becoming another form of government subsidy for arms trade to Lockheed Martin and Boeing. This money is not going to Poland, Israel, or Egypt. So essentially, the U.S. military aid stops briefly at the Pentagon, then heads directly to Lockheed Martin, Boeing, Raytheon, and other big military contractors.

The Pentagon and the military industry become natural allies in terms of identifying external threats. They argue that the United States needs to improve its intervention capability and deploy TMD and NMD systems against rogue states.

Elite Monopoly of Defense Policy-Making

The U.S. is a democratic society and the government must give enough consideration to public opinion during policy-making. Nevertheless, defense policy-making is an exception and monopolized by the elite only. (In fact, the situation is similar in many countries. But that is no reason to deny its important role in American defense policy-making.) In general, American people have no knowledge of why the military budget should account for 3-4 percent of GDP.

Current thinking in Washington on U.S. military spending is largely shaped by an elite policy-making community, which includes the president and the executive branch, the Pentagon, Congress, policy analysts, and, of course, the media. Meanwhile, the American public has been largely a silent partner in this debate. American opinion leaders feel that the United States should play a first-among-equals role among leading nations; more assertive than other leading nations. U.S. policy-makers favor reliance on the military as a force for peace in the world. As such, U.S. troops have been sent to the Persian Gulf to deter Saddam Hussein from aggression, help the starving in Africa, keep the peace in Bosnia, and protect U.S. citizens in Liberia. Increasingly, U.S. policy-makers seek to play the role of a global policeman, by policing internal civil wars in Bosnia, sustaining a force in Iraq or around Iraq indefinitely, and sustaining troops on the border of North Korea on the other side of the globe. And these are all missions, and many more, that policy-makers have on their agenda that makes them want to have a much bigger military and spend a lot more money than perhaps the public would prefer. Worldwide military spending has steadily declined from a high of \$1.3 trillion in 1987 to \$840 billion in the late 1990s. The U.S. military budget is a staggering one-third of the worldwide total. A quick look at the top twenty military spenders reveals that the United States far outspends the other following eighteen countries combined and most of the countries in the top ten are U.S. allies.

Meanwhile, the American public has been largely a silent partner in this debate. There is a significant gap between what policy-makers think and what the American public actually thinks. The American public thinks that America should not play a more influential role than other leading nations but should just be one of the leading nations that deals with global problems. The American public has a different view from policy-makers. They question those threats to U.S. security that justify increased military spending. Policy-makers often point to the so-called “rogue states,” such as Iran, Iraq, North Korea, Libya, Syria, and Cuba, as potential adversaries. However, when compared to the military budgets of potential adversaries, U.S. military spending dwarfs the spending of all of them combined. In

the 1990s the rogue nations collectively spent about \$15 billion on their military each year. The United States spent over \$250 billion. None of them, except perhaps Cuba, has a weapon that can even reach American shores. The public cannot find the real threat that justifies huge military spending. Hence, the Bush Administration can only play the same old tune of the fallacy of the “China Threat.”

The public also has a different view on what America’s place and what America’s leadership in the world should be. They don’t really feel that the United States needs to have as robust a military as it presently has. Overall, when you ask them how they feel about defense spending, they lean in the direction of wanting it to be less. The average American wants to cut defense spending about 10 percent. How much should the United States spend to defend itself each year? Steven Kull asked people for their answer to this question, taking into consideration spending by six potential enemies: Russia, China, Iran, Iraq, Libya, and North Korea. Forty-eight percent of them said that the United States should spend a bit more than the strongest potential enemy. Twenty-nine percent said that the United States should spend as much as all of them combined. Only 7 percent said that the United States should spend twice as much as all of them combined. In fact, the United States does spend about twice as much as all of them combined. In addition, 63 percent of those surveyed said that the U.S. military spending “has weakened the U.S. economy and given some allies an economic edge.” Sixty-nine percent felt that it is not necessary for the Pentagon to improve the U.S. military technology and build expensive capabilities. And 89 percent agreed that “countries that receive protection from the U.S. military capabilities … rely too much on the U.S.”

Military issues are regarded as top secret and people seldom question what kind of military capability they need for their security. This tradition gives the elite a free hand to increase military budgets. Meanwhile, military strategy is regarded as a technical thing and people leave it to security experts. Therefore, policy-makers can find all kinds of reasons to support new weapon R&D programs. Although many scientists doubt the reliability of the NMD system, people in the streets responded very little

to the debate on the NMD plan. The monopoly of defense policy-making by a political elite makes the U.S. government able to increase its military budget in an improved security environment.

In order to meet the economic interest of the defense industries, draw economic support from them for the next general election, and stimulate the declining American economy, the Bush Administration will inevitably increase in the next few years its defense outlay possibly by a two-digit annual growth rate. After the Cold War the U.S. military budget is determined more by domestic factors than foreign elements. This fact provides two implications for international relations. First, the international threats claimed by the United States are more excuses than reality. Second, the unnecessarily large U.S. military spending will increase others' suspicion of America's political motivations.

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National Security Policy-Making by the CCP: The Role of Domestic Factors

Boris T. Kulik

As the current epoch becomes ever more complicated, a variety of political science and world-view concepts appears in the field of social sciences. Under the assault of new, “fashionable” views, the fundamental laws of social development, discovered by our predecessors, sometimes are put to oblivion or crossed out arbitrarily. These laws include, among others, the eternally valuable conclusion that the foreign policy of any state is determined first and foremost by its domestic policy, is a follow-up of domestic policy, and basically proceeds from the social system of the given state. Also, foreign policy cannot but be influenced by major events occurring in the given state — especially economic crises, social and ethnic conflicts, and power struggles. Even some catastrophic natural calamities, which have very little if anything to do with domestic policy as such, by their social and economic consequences, can affect foreign policy.

Considering the ultimate significance of these cornerstone provisions, one cannot but pay due tribute and express appreciation to our Japanese

colleagues who have put a most acute and important issue on the agenda of this international academic forum.

Chinese Specifics

Being universal, the postulate on the primacy of domestic policy over the foreign one manifests itself quite specifically in the case of China. This is evident for several reasons. The main reason is the incredibly dramatic metamorphosis, undergone by China one and a half centuries ago, when the great and strong power, which identified itself as the Celestial Empire (i.e., the possessor and ruler of everything covered by the heaven, and which really dominated over all thereto known countries and nations — the power, which had no rivals) became a humiliated, devastated, powerless, and rightless victim of foreign invaders who threw it to the backyard of the international community. As a result, the Han nation, which, according to its most ardent apologists, had created the greatest civilization when Europeans were still “living on trees,” was doomed to live not only in poverty and backwardness, but also in the position of meager and primitive tribes.

In those circumstances, the Chinese people quite naturally strove to restore the power and prosperity of their motherland. Having passed the difficult road of maturation and formation, the most important stages of which included the Xinhai Revolution and People’s Revolution, crowned by establishment of the PRC, this effort has become the central idea and the main engine for China’s development.

The condition of extreme weakness experienced by China at that time totally ruled out any possibility to realize its revival by means of foreign policy, whatever sophisticated diplomacy was applied. And, the use of military force was out of the question; as the Chinese army had cardboard swords, like the severe personages of Peking opera.

In the difficult search for an exit from the unbearably painful situation, the fighters for China’s revival realized that only by overcoming the detrimental backwardness, which corroded all spheres of the life and activities in the country, would they be able to transform China from the colossus on clay legs into a really strong power. The kernel of this idea,

planted thoroughly by Sun Yat-sen, grew to the full understanding that the first-priority task was to build up the inner forces of the country, i.e., priority of the domestic over foreign policy.

National independence, gained by the Han people with the establishment of the PRC in 1949, provided the necessary prerequisite for the revival of China. However, this resolved only a part of the great historical task. Then the economic backwardness of the country became even more evident. Even twenty years after 1949, production of energy in the PRC was 1.7 times less than in Italy, 1.9 times less than in France, 3.7 times less than in Britain, 4.4 times less than in Japan and 25.3 times less than in the United States. The volume of energy production was more or less comparable to that in the German Democratic Republic, where the population was 1/40 of the population in China.¹ The PRC's lag behind other countries in other sectors of industrial production was no less amply evident. In terms of per capita production, the gap between China and developed countries was even more impressive.

In these circumstances, economic growth became the most important core task to revive China; both because “policy is concentration of economy”² and “the deepest roots of domestic and foreign policy are determined by the economic interests.”³ Despite all the contradictions and even zigzags in the history of the PRC, the essence reflects the search for ways, means, and methods for acceleration of national economic growth. This priority has become most solid in the last two decades of the 20th century, and exactly this factor should serve the starting point for analysis of Beijing's domestic and foreign policy.

The stronger primacy of domestic over foreign policy in the PRC than in other countries also can be explained largely by the fact that the PRC is a socialist country. Therefore, there is the coincidence between the objective (the need to overcome China's backwardness) and the subjective (purpose-

1 B. Koloskov, *Vneshnyaya politika Kitaya. 1969-1976 [China's Foreign Policy, 1969-1976]*, Moscow, 1977.

2 V.I. Lenin, *Full Collected Works*, Vol. 45, p. 123 (in Russian).

3 *Op. cit.*, Vol. 36, p. 327.

oriented policy by the ruling party, the CCP) factors of domestic and foreign policy-making in the PRC. The CCP leadership is not simply led by the trend for revival of China, but considers realization of this trend as its main task, organizes and directs the process of such realization, and successfully eliminates everything that hampers this process. The priority of the PRC domestic development tasks, expressed in the “self-reliance” formula, is fixed in the PRC Constitution and CCP policy documents. With all its importance, the “open-doors” course does not serve as the main but rather a supplementary instrument to reach economic growth and to attain the objectives of China’s revival. A meaningful point is that the economic growth is being stimulated mainly by domestic savings rather than foreign investments, which in the last 10 years provided only 5 percent of the GDP growth in the PRC.

The security problem, too, appears quite specifically in the PRC. This is connected with the fact that the PRC is a socialist country. Therefore, the ruling communist party in the PRC is faced with the task not only of providing for national security, but also for preserving and consolidating the existing social system. In the 1950s the second task was being resolved on the basis of socialist transformation in urban and rural areas, as well as through suppression of anti-socialist forces. Today the major precondition for resolution of this task as well as for protection of national security is seen in the economic growth and improvement of living standards of the people. So, in this sphere, too, domestic policy with its main economic axis assumes to priority.

At the same time, the methods to solve the second task are marked by some important peculiarities. Today, the sphere of ideology has become the main battlefield, and information warfare the main form of struggle. Information warfare proved quite efficient in the case of the Soviet Union, where it played the central role in the destruction of the socialist system.

Certainly, the foreign policy of the PRC, like that of any other state, is relatively autonomous, has a number of its own laws and logic, and is affected not only by the process of domestic development, but also by the outer circumstances, (e.g., general international situation and relations vis-à-vis China by other states). Moreover, all these factors render influence on domestic policy — sometimes so strongly that they deform it

and lead it away from the mainstream direction. This happened several times, and an ample case in point is the consequences of the Sino-Soviet split. At that time, the task to protect national security came to the forefront of PRC domestic policy. This component can even become a dominating one — as a result of not only objective factors (appearance of a real threat) but also subjective factors (unintentional or intentional overstatement of a threat by leaders of the country). Both cases occurred in the course of the Sino-Soviet quarrel.

The Taiwan issue strongly affects Beijing's security policy. This issue adds more specifics to the question of correlation and mutual influence of China's domestic and foreign policy. Many political scientists tend to consider the Taiwan issue as a purely foreign policy affair, and consider Beijing statements to the effect that it is China's domestic affair as nothing else but a mere formality and demagogic rhetoric. However, the reality is much more complicated. The significance of Taiwan's reunification with the mainland extends beyond the national task of restoring China's territorial integrity. Reunification would have very profound consequences for the domestic situation in the PRC and the future of its social system. It is not at all clear how this system would stand in co-existence with the capitalist system of Taiwan, which by all dimensions is superior to the capitalist enclave of Hong Kong. From this perspective, the Beijing-style resolution of the Taiwan issue can, however paradoxically this might seem, frustrate rather than consolidate security of the PRC. At least, the tasks facing the CCP would become tangibly more difficult.

Security Issues in PRC Domestic Policy at the Current Stage

Since December 1978, when the 3rd Plenum of the CCP CC put the task of China's modernization in the focus of all efforts by the party, state, and people, the shaping of Beijing's position with regard to national security has undergone three major changes. Each time, this was accompanied by fierce discussions within the leadership of the CCP, and each time the question was raised by the initiative of Deng Xiaoping.

The need to proceed to a new foreign policy strategy was revealed most amply for the first time in the early 1980s, when it became absolutely evident that the guidelines of the CCP 11th Congress (1977), confirmed in June 1979 at the session of People's Assembly (i.e. after the 3rd Plenum), did not correspond to the interests of China's modernization. These guidelines included the conclusions on the growth of international tensions threatening to grow into a new world war, the use of rivalry between the Soviet Union and United States, China's active role in the struggle against imperialism, and continuation of the struggle against "Soviet social-imperialism." Before that time, such guidelines had been justified in overcoming of then appearing difficulties and in collision with major circumstances. For example, the external threat and sustenance of the besieged fortress situation in the PRC had fueled the mechanism of mobilization economy, while anti-Sovietism has been used as a means to develop relations with imperialist countries.

Later on, however, when the objectives of economic growth were regarded as independently important, different — longer-term and more sustainable — conditions were required for attainment of those objectives. In January 1980, Deng Xiaoping announced three major deeds which China was to realize in the 1980s: "on the international scene, to act against hegemony"; "to return Taiwan to Motherland"; and, "to accelerate the course of modernization." As far as the order of priorities was concerned, Deng said that modernization "is the most fundamental basis ... Therefore, beginning from the first year of the 1980s, without losing a single day, we must concentrate all our attention and all our efforts on modernization of the country."⁴ Since that moment, the task to create the maximally favorable conditions for realization of the set objective was the main focus of domestic and foreign policy. Within the country, the main prerequisite for success was seen in sustained political stability. The latter task required repudiating the line of class struggle, and that became possible owing to the end of the Cultural Revolution. On the outer scene, the task was to attain a peaceful international situation that would not distract resources of the PRC from modernization and would allow using cooperation with other countries in the interests of modernization.

4 Deng Xiaoping, *Selected Works (1975-1982)*, Beijing, 1985, pp. 262-263 (in Russian).

The first and the main need of China's modernization was not to allow a new world war, which had been seen by Mao Zedong almost as a benefit. A worldwide military catastrophe would totally frustrate all plans for the restoration of a powerful and prosperous China. Even a local large-scale conflict, which inevitably would divide all countries by blocs and camps, could involve the PRC into its orbit and thus impede its economic growth. Hence, there was the need to revise the theoretical clause on the inevitability of a new world war and to repudiate all practical actions that would undermine international stability.

Hostility against the Soviet Union no longer had a practical value as a means to improve relations with capitalist countries, which reached the point where they could grow independently, without being fueled by anti-Sovietism. Other, mainly economic factors entered the game.

As for Sino-American relations, Beijing had chances to understand that their development was tightly restricted and strategically the United States continued to be an adversary of the PRC. Having initiated the course to rapprochement with the United States, Chinese leaders hoped that it would facilitate resolution of the Taiwan issue. The communiqué of the 3rd Plenum stated: "With normalization of relations between China and the USA the even broader prospects opened for us to return the sacred Chinese territory of Taiwan to Motherland and to realize the great cause of reunification."⁵ However, exactly this issue brought grave disappointment for Beijing. Three months after establishment of diplomatic relations between the PRC and United States, Washington passed the Taiwan Relations Act, designed to prevent reunification of the island with the mainland part of the PRC. Not incidentally, the fiercest disputes among the Chinese leaders at that time centered on no other issue but relations with the United States, and many stood for the continuation of a hard-line American policy.

Even with the persistence of Deng Xiaoping, formulation of the new foreign policy took a number of years, and finally was articulated in the platform of the CCP 12th Congress held in September 1982.

5 *Renmin Ribao*, December 24, 1978.

The importance of modernization was regarded as absolute and the main factor to protect the PRC's security. Deng Xiaoping pointed out the following: "Like the struggle against hegemony on the international scene return of Taiwan to the Motherland and realization of national reunification implied successful economic construction."⁶ This view served as the basis for the concept of comprehensive power, the build-up of which was essential to guarantee the security of the PRC. At that time, the role of defense capacity and armed forces of the country was regarded as secondary in the realization of this task.

In the early 1990s, for the second time, the security problems of the PRC became a subject for fierce discussion in the CCP leadership. The reason was the disintegration of the USSR and the collapse of the socialist system in East European countries. In Beijing, those events were perceived as the prologue to an attack by anti-socialist forces against the positions of socialism in China. Such an attack was regarded as an attack on China's national interests because from the very beginning socialism was understood by the CCP leadership as a form and means of national revival rather than as an abstract ideological doctrine. Such a perception was aggravated by the anti-government rallies with anti-socialist slogans that started to take place in the PRC from early 1989. In May-June of the same year they resulted in the renowned demonstrations in the Tiananmen Square.

The events of 1989 drove the CCP leaders to the conclusion that successful economic construction *per se* would not guarantee national security because security could be undermined by special means, which now are defined as media and information warfare. Deng Xiaoping repeatedly pointed to the reasons that generated the anti-government demonstrations of summer 1989 in Beijing. In particular, he said: "The Western world, especially the United States, launched into operation its propaganda machine in full power, and, using the mechanism of instigation, by all possible means inspired and supported the so-called 'democrats' and 'opposition figures' within China, who in fact were renegades of the

6 Deng Xiaoping, *Selected Works (1975-1982)*, Beijing, 1985, pp. 263.

Chinese nation. This resulted in the situation that has led to disorders.”⁷ Deng also made it clear that “in the United States and some other Western countries, they nourish the hope for a peaceful evolution in socialist countries”; in the past, he said, capitalism tried to win a victory over socialism “with the help of weapons as well as atomic and hydrogen bombs, and this generated rebuff on the part of all peoples of the world. Today, it has resorted to peaceful evolution.”⁸

Discussion of the ways to protect security in the given situation was underway within the CCP leadership. Some leaders spoke in favor of a hard-line policy towards the United States as a response to U.S. economic sanctions, and to this effect they proposed further construction of armed forces. However, the interests of modernization prevailed again. Deng Xiaoping drew the conclusion that the United States would not dare to exert far-reaching pressure on the PRC. A weighty argument to support this conclusion was found in the normalization of Sino-Soviet relations, which occurred at the peak of the Tiananmen events and caused tensions between Beijing and Washington. At the same time, however, it would be unwise to act against the United States or the principle of “spearhead against spearhead.” So, the only option for the PRC was to use business ties with the West, including the United States, in the interests of modernization. To this end, it was necessary to continue the open-door policy for which any confrontation was counter-productive. Given such considerations, Deng Xiaoping proceeded step by step to settle Sino-American disagreements. As soon as October 31, 1989, during his talks with former President Nixon, Deng called for “drawing the line under the past months and opening doors to the future.”⁹

At the same time, China decided to take measures that would neutralize the pressure from the West through the activation of China’s relations with its nearest neighbors and devoting increased attention to Russia, Vietnam, and India. China interpreted comprehensive power in

7 Deng Xiaoping, *Selected Works (1983-1992)*, Vol. 3. Beijing, 1994, pp. 437 (in Russian).

8 *Ibid.*, p. 409.

9 *Ibid.*, p. 417.

much broader terms that included not only the economy, but also such factors as the moral and political unity of the people. The improvement of living standards of the population, activation of measures to counter the information warfare by more profound ideological work with the population, as well as the broader propaganda of patriotism, national values, and ideals of socialism. The task was set to draw the lesson from the fact that neglect of these components of comprehensive power resulted in the collapse of such economically developed powers as the Soviet Union, while a much smaller country, Serbia, owing to the unshakable morale of her people, was able to withstand the attack of the **military monster** of NATO!

In view of all these considerations China found it appropriate to continue working with the United States and the West without putting emphasis on defense construction. There were serious hopes that the Western countries again would be attracted by the benefits of economic cooperation with the PRC. Deng Xiaoping said to Richard Nixon: “The Sino-American relations have a good basis. Whatever you say, the Chinese market is not explored sufficiently so far, and in order to use it, there is much to be done by the United States.”¹⁰

The PRC security problem was not, according to Deng Xiaoping, the threat of military aggression, but rather with a violation of national sovereignty in the form of interference in China’s domestic affairs, which could take place without military action. Hence Deng’s formula: “Sovereignty and security of the state must be put always to the first place.”¹¹ This, too, is connected with the main task (i.e., modernization of China), as the interests of modernization would be damaged in case interference in PRC domestic affairs generates disorders that would undermine domestic stability. According to Deng Xiaoping, the events of the summer 1989 made Chinese leaders understand even more profoundly that the “protection of stability is the decisive factor for China in the elimination of poverty and the realization of modernization in the four spheres.”¹² So, security of the PRC was

10 *Ibid.*, p. 419.

11 *Ibid.*, p. 437.

12 *Ibid.*, p. 438.

interpreted as making a situation in which nothing would threaten the modernization of the country. A meaningful point is that the Law on Defence, passed in the PRC in 1997, says that the PLA, apart from the tasks of defense, shall provide assistance to restoration of public order in necessary cases.

However, Deng Xiaoping also stated that if China is brought into chaos, “it will be a calamity of the global dimensions” because hundreds of millions of Chinese refugees would flood other countries.”¹³

After the collapse of the USSR, the prospect opened for China to replace the Soviet Union as one of the world’s leaders. However, Deng Xiaoping repudiated the chance, as it would interfere with concentration on the task of China’s modernization. In December 1990, Deng stated: “To be in charge of something is an unrewarding business, which also is connected with the considerable loss of initiative,” and recommended “without assaulting anybody, to act on the basis of five principles of peaceful co-existence.”¹⁴

The 14th Congress of the CCP, which took place three years after the Tiananmen events, decided to consolidate the PRC armed forces in the following way: “To build up defense power in order to provide for success of reforms, expansion of foreign ties and economic construction.”¹⁵ By the time the Congress was convened, the size of the PLA had been reduced by one million personnel. The Congress stated that “the current period has become one of the best periods of China’s friendly good-neighbor relations with the neighbor countries since establishment of the PRC,” and that China’s relations with all states in the world, including developed countries of the West, were improving and becoming more perfect.¹⁶

Five years later, this assessment of the foreign-policy situation was confirmed by the 15th Congress of the CCP (1997), which stated, “in a whole, it continues to develop towards détente,” and that “the strive for peace and co-operation as well as contribution to development has become the mainstream

13 *Ibid.*, p. 452.

14 *Ibid.*, p. 456.

15 *Renmin Ribao*, October 21, 1992.

16 *Ibid.*

of the epoch.” Again, the Congress emphasized that “for realization of the socialist modernization we need the long-term peaceful international situation and the most favorable environment.” However, this time the Congress devoted more attention to military construction, and even proclaimed the thesis: “Consolidation of the national defense and army construction is the basic guarantee of our national security.” However, this thesis was immediately subordinated to the cause of “successful modernization.”¹⁷ This did not at all mean any revision of the role of the modernization and open-door policy as the main factors to protect national security. The task of the army construction emphasized construction of a compact and well-selected army operating with modern and high-technology equipment. On this basis, China planned to reduce the size of armed forces by another half million personnel within three years.

That Deng’s opinion was decisive in those years is not the only reason for the above frequent quotations from his instructions. What is more important, Deng’s ideas, embodied in the theories of socialist construction with Chinese characteristics and encompassing all facets of life and activities in the PRC (including its security), are taken by the CCP as the guideline for action in the long-term perspective. At the 15th Congress Jiang Zemin, having noted that the CCP “is the party, attaching an exceptional importance to the directing role of theory,” stated that the theory of Deng Xiaoping “is the correct theory, leading the Chinese people to the victorious realization of socialist modernization by means of reforms and openness.”¹⁸

According to published data, the PRC has elaborated a long-term program for military construction to be accomplished in three stages. By the end of the first stage in 2000, the armed forces must be capable of defending the state interests of the PRC by successfully conducting local warfare at a low and medium intensity along the entire border, as well as solving the tasks of efficient “containment” and “deterrence” of potential adversaries. At the second stage around 2010 the PLA must be transformed into a force that would guarantee expansion of “strategic borders and living space” for China. In the course of the third stage by 2050 the

17 *Renmin Ribao*, September 22, 1997.

18 *Ibid.*

armed forces must be able to win victory in a war of any scale and duration through the use of all means and methods of armed struggle.¹⁹ Widely circulating in the military-political circles of the PRC has been the concept by which the “living space” should “provide for security and life activities of population as well as its economic and science-tech development.” Strategic borders are understood as “territorial and space frontiers, marking the limits within which the state can efficiently protect its interests with the help of real force.” In the case of armed conflicts involving China, it is considered admissible to relocate armed hostilities from the areas within China’s state borders to the zones of “strategic borders” and even beyond. It is assumed that a conflict might be caused by difficulties in the “protection of legitimate rights and interests of the PRC in Asia-Pacific.”²⁰ As for the currently effective doctrine of Beijing, it is of a defensive nature and proceeds from the understanding that in the near-term future the probability of a large-scale war or a direct aggression against the PRC is rather low.

The third turning point in the formulation of Beijing’s position with regard to security issues took place in 1999. This turn was made because of *NATO aggression* against Yugoslavia. The concept articulated at that time, continues to be valid until now. While the former basic guidelines are preserved in the present concept, a new element is seen in the higher significance of the military component in the complex of measures designed to protect the security of the PRC. The NATO aggression against Yugoslavia has led Beijing to the conclusion that the United States has not abandoned the use of force to reach its objectives. Moreover, Beijing fears that verbal reprimands from Washington to other states, including the PRC, for some misbehavior (e.g. human rights violations) could be followed by hard-line practical actions, including armed hostilities. The U.S. missile attack on the PRC Embassy in Belgrade was interpreted in Beijing as a warning. I happened to be in Beijing at that time, and I did

19 Information collection *Po zarubezhnym stranam i armiyam* [By Foreign Countries and Armies], No. 5 (116). General Staff of the RF Armed Forces. Moscoe, 1996.

20 *Ibid.*

not meet a single Chinese person — whether an official, a scholar, or a common man in the street — who believed that the attack was not intentional. While talking with the PRC Foreign Minister Tang Jiaxuan at the APEC summit of 1999 in Oakland, the U.S. Secretary of State Madeleine Albright rejected the assumption that the United States might treat the PRC in the same way as it treated Yugoslavia as “total nonsense,” but this statement did not comfort leaders in Beijing. There was no reason for benevolence, as President Clinton’s message to the U.S. Congress, entitled “A National Security Strategy for a New Century” (October 1998) stated that the U.S. strategic approach is based on the understanding that the United States must be the leader in the world, and must be prepared to use all necessary instruments of national power in order to influence some or other actions of other governments and non-government actors of international relations.²¹

The CCP leadership is gravely concerned by U.S. plans to build a missile defense system. As stated in the Joint Statement by the Presidents of the PRC and RF of July 18, 2000, realization of this plan would bring most serious consequences for the security of China and Russia.²² A direct threat to the security of the PRC is seen in the U.S. intention to deploy the TMD system in the Asia-Pacific and to have Taiwan involved in it.

However, Beijing has not chosen to build up military construction excessively, as it is aware that competition with the United States in this sphere would not bring a victory to the PRC but would frustrate the program of China’s modernization. All the detrimental consequences caused to the Soviet economy by the involvement of Moscow in an arms race with the United States, have been thoroughly analyzed in Beijing.

By all evidence, Beijing’s main response to U.S. missile defenses is asymmetrical and concentrated on political measures. For example, a major aspect is seen in the consolidation of relations with neighboring countries — Russia and other Asian countries of the CIS that together with China form the Shanghai Five, as well as with India. At the same time,

21 *A National Security Strategy for a New Century*, Washington, October 1998.

22 *Renmin Ribao*, July 18, 2000.

efforts are being taken in order to improve, based on the concept of a multi-polar world, relations with such poles or centers of power as Japan, ASEAN, and the European Union. Such a strategy would introduce difficulties in Washington's actions vis-à-vis China.

What Is There for the PRC in the New Century?

Quite unfortunately, the foreseeable future does not promise to be easy and cloudless for the PRC. Suffice it to say that many difficult problems of today will remain for tomorrow.

The number one of these is the unresolved Taiwan issue. In early 2000 Beijing stated that it would resort "to all possible resolute measures, including the use of force," should Taiwan refuse "for an uncertain time" to conduct negotiations on reunification. At the same time, a draft law on the consolidation of Taiwan's security, providing for restoration of a U.S. alliance role for the island, was introduced for consideration by the U.S. Congress. It is not so difficult to see what detrimental consequences for PRC security would be caused by the practical realization of the amply expressed contradictory approaches to the Taiwan issue on the part of Beijing and Washington.

There is an objective need for PRC and India mutual rapprochement that would help to counter hegemonic intentions to establish a uni-polar world. However, an agreement, signed by the two countries in November 1996 is not sufficient for this need to be realized. Beijing and New Delhi will have to make relentless efforts in order to clear their bilateral relations from the burden of territorial claims. India is catching up rapidly with China by the size of population and becoming a power with a huge economic and military potential. According to Chinese forecasts, by 2010 India will join the ranks of "global military powers of the first class."²³ In this context, one should not exclude a danger of rivalry, detrimental for both, between the two Asian giants in the 21st century.

23 *Xiandai Guoji Guanxi Yanjiu*. Beijing, 1996, No. 3, p. 29.

The PRC could hardly manage to evade serious domestic difficulties, too. However paradoxical this might seem, the main sources of these are the same factors that provided for the successful development of the country in the last 20 years; i.e., the economic reforms that contain such dangerous shortcomings as the deepening stratification of Chinese society. The latter might generate social conflicts that would undermine domestic stability which is vitally needed for China's modernization.

More recently, separatist trends in Xinjiang, actively encouraged from abroad, have become a more disturbing phenomenon. There, in Xinjiang, Islamic fundamentalists, too, are trying to root themselves. These developments threaten to spread beyond the borders of the PRC and aggravate its relations with the Muslim world.

Chinese leaders are quite concerned by the current developments in Russia. Repeated statements by the PRC leaders saying that they want to see Russia as a strong and stable country are not a mere rhetoric, dictated by diplomatic politeness. Russia certainly is the main and most efficient foothold for China in the struggle against hegemony. Today, Russia is not just the main, but also the only source of advanced types of weapons for the PRC. According to the Associated Press information of July 19, 2000, financial volume of Russian-Chinese relations in the military sphere exceeds 2 billion USD per year.²⁴ This takes place in spite of the fact that the roads of social development of the two countries have drifted apart. In this connection, we cannot help recalling the words of Mao Zedong in the worst days of the Sino-Soviet conflict: "In case of a war we shall stand together." Leaders in Beijing certainly understand that a weak Russia, should she happen to depend on other powers, would become their tool of struggle against China. In view of the fact that the PRC-Russia border is one of the lengthiest in the world it is not difficult to foresee how Beijing would react in case, for example, NATO appears at this border.

Relations of equal and trustful partnership and strategic co-operation between Russia and China meet the security interests of both countries. At the summit of July 18, 2000, Presidents Vladimir Putin and Jiang Zemin

24 *Renmin Ribao*, July 18, 2000.

said that they were satisfied by the course of the RF-PRC cooperation “in preservation of the global strategic balance and stability.”²⁵ Moscow and Beijing announced their intention to sign the treaty of good-neighborliness, friendship, and cooperation.

Turning to the prospects for the 21st century, there are many reasons to say that the PRC has a sufficient reserve of solidity to cope with the forthcoming difficulties and trials. In August 2000, during his visit to Moscow, Dai Binguo, head of the CCP CC International Department, said: “Today the Communist Party of China develops its strategy, which is relevant to the challenges of the 21st century. We solve the tasks of construction of the stronger and more powerful party that is capable of ruling the state efficiently and preparing the country for the fierce world competition in the spheres of economy, science, equipment, and technologies.”²⁶ Beijing has all the bases, built in the course of the two decade-long modernization processes, to be confident of success.

25 *Associated Press*, July 19, 2000.

26 *Pravda*, August 24, 2000.



Russia's Security Debate in 2000: Superpower vs. Great Power

Kyong-wook Shim

Introduction

On July 12, 2000 at a colloquium of the Russian Defense Ministry, a contentious debate burst into public view. Chief of the General Staff Anatoli Kvashnin recommended that Russia's strategic nuclear force be absorbed into one of the other branches of the armed forces and nuclear force spending be instead directed towards conventional forces. Hours later, Defense Minister Igor Sergeyev publicly blasted Kvashnin, calling his proposal a "crime against Russia and just plain madness."¹ Sergeyev held that the existing armed forces structure should be preserved with the Strategic Missile Forces remaining as a separate branch of the military responsible for Russia's land-based intercontinental ballistic missiles.²

1 Aleksandr Shaburkin, "Chem mozhet zakonchit'sya konflikt ministra obrony nachal'nikom genshtaba," *Vremya MN*, July 15, 2000, p. 1.

2 David Hoffman, "Rift Deepens In Leadership of Russian Armed Forces," *Washington Post*, July 14, 2000, p. A16; A. Shaburkin, "Tol'ko prezident mozhet utikhomirit' voe-nachal'nikov," *Vremya MN*, July 15, 2000, p. 1.

Such a public conflict between the defense minister and the head of the General Staff is unprecedented in Russian military history. It reflects the serious crisis that exists in the political management of the armed forces just at the time when Vladimir Putin is beginning to define his role as head of state. Having little choice, President Putin was forced to intervene and demand that the public recriminations cease. Additionally, he placed the decision-making process for further reforms in the Russian armed forces under presidential control.

This schism, however, was considerably more significant than just an unusual public debate between two leading Russian defense officials — the future of Russian national security was at stake.³ Since Russia first exploded a nuclear warhead in August 1949, its nuclear arsenal constituted less an instrument of war than a measure of self-image for Soviet Russia, which enjoyed the title of “superpower” through nuclear parity with the United States. Even in post-Soviet Russia many Russians hold a similar perspective. Therefore, the outcome of this explosive debate on the “optimal scheme of balance between the nuclear deterrence forces and combined armed forces” defines not just security policy, but nothing less than how Russia views its standing in the world arena.

Importantly, this debate foreshadows one of the key issues that will define both Putin’s presidency and Russia’s future. The way Moscow reorganizes its defense capabilities in the coming years will reflect whether Russia intends only to be a “great power” or whether it still aspires to the status of “superpower.”

Because of these implications, this conflict presents a unique context for an analysis of the impact of domestic factors on Russian security policy. The fervent debate in the military hierarchy provides an insightful, if not comprehensive, glimpse of a spectrum of domestic factors that will influence Russian security policy during the years to come. At the same time, the actors linked to this debate illustrate a microcosm of several aspects of contemporary security policy-making that drive Russia toward

3 Andrei Piontkovsky argued that the fact such a crisis occurred is a strong argument in favor of civilian management of the armed forces. A. Piontkovsky, “Season of Discontent: Kvashnin and the Experts,” *The Russian Journal*, August 19-25, 2000.

a more realistic and pragmatic security policy. These actors, besides the obvious prominence of the armed forces, include the president, the Duma, the military industry complex, and the mass media.

In actuality this controversy over how much Russia should depend upon its nuclear arsenal stems from the beginning of the 1980s. Marshal Nikolai Ogarkov, then chief of the General Staff, asserted that the nuclear arsenal was already doomed because of the imminent advent of energy-directed high-precision armament for hi-tech warfare. Yuri Andropov (General Secretary of the Communist Party, 1982-84) believed the same. Civilian security experts also joined the debate. One such expert, Andrei Kokoshin, emphasized, even before being selected as deputy defense minister, that rather than depending excessively upon its nuclear capabilities Russia should concentrate its limited resources on the development of general-purpose — read conventional — capabilities. Clearly, this controversial debate has been an underlying part of Soviet/Russian military thinking for at least the last two decades.

As Russia's economy continues to show a weak performance, however, the scope and cost of the Russian nuclear arsenal has come under increasing scrutiny in the security community. Kvashnin's comments only served to re-ignite this long-standing argument, albeit in a very public way. Unlike previous comments, this time Kvashnin's voice left permanent imprints on the Russian security-military policy.

To better understand this enduring impact, this paper will identify and analyze Russian domestic factors that affect the formulation of its security policy. In the context of last summer's heated debate inside the military hierarchy, I will attempt to illuminate the reasons why Russia, after years of consideration and hesitation, has no other recourse but to abandon pursuit of the "superpower" status it had achieved by means of its nuclear parity with the United States.

The Core Issues

Chief of the General Staff Kvashnin's July 12 proposal called for the subordination of the missile troops to the army while slashing their strength

to one-seventh of its present size.⁴ According to him the cuts could be made because Russia's missile arsenal had shrunk to a size that no longer required direct and independent management. Practically, Kvashnin's proposal sought to enhance the authority of the General Staff over the nuclear forces and shift resources from nuclear to conventional forces.

Defense Minister Sergeyev's rebuke was prompt and abrupt. Sergeyev, an army marshal and former head of the nuclear missile forces, made it clear that he was adamantly against the plan. Sergeyev intoned at the next day's meeting that any change in the military structure should be "approached reasonably" and that Kvashnin's proposal was a "remote" idea given the ongoing course of arms control talks with Washington.

Responding to this quarrel, outside observers could not but look to President Putin for his reaction. Only two days later, on July 14, Putin shut down the military chiefs' publicization of the issue while on a visit to an armament exhibition in Nizhny Tagil. There, he unequivocally affirmed, "There is no reorganization of strategic missile forces as such."⁵ Nevertheless, in a move that sent mixed signals, on July 31, President Putin fired six top generals that weakened Defense Minister Sergeyev's position, since among those terminated was procurement chief Anatoli Sitnov, who reportedly had opposed the Kvashnin plan and had been allied with Sergeyev.⁶

Less than a month later, on August 11, the Security Council met to discuss the future of the armed forces through 2016. According to the resolutions approved by the Security Council, the Strategic Missile Forces will remain an independent branch of the armed forces until at least 2006. However, the Council projected that the number of nuclear warheads the Russian Strategic Missile Forces will possess by 2010 will not exceed 800,

4 Kvashnin proposed eliminating 16-17 missile troop divisions and firing 3,000 rocket specialists. He also proposed drastically reducing the production rate of the single-warhead Topol-M missile from the current ten per year to two per year. As a result, the nuclear forces' share of the military budget would be reduced from 18 percent to 15 percent.

5 "Putin zayavlyayet, chto reorganizatsii RVSN kak takovoii net," *Interfax*, Nizhnii Tagil, July 14, 2000.

6 Igor Davydov, "Nyneshnij konflikt v rukovodstve Minoborony RF mozhet privesti v kreslo voennogo ministra grazhdanskoe litso," *Interfax*, August 1, 2000.

while an additional 700 warheads will be deployed with strategic aviation and naval forces. Additionally, the overall number of the Strategic Missile Force divisions will be reduced. It is planned that production of the Topol-M missiles will continue, but the major part of acquisition funds for the strategic component of the armed forces will be spent on the development of “new technology” weapons, cruise missiles for the air force and navy, and a new generation of naval ballistic missiles. However, the Council stressed that projects for the so-called general-purpose forces will also be developed and financed, meaning that priority of funding will no longer be given to strategic nuclear forces.⁷ Increasingly, the main cash flows will be directed towards enhancing the combat potential of the general-purpose forces.

The resolutions made by the Security Council seem, at first glance, to be measures for balancing the nuclear and conventional capabilities of Russia. But this first-phase decision bodes much more for the future orientation of Russian security policy.

This decision disappointed the Ministry of Foreign Affairs; the Ministry fears that Russia’s unilateral reduction of its nuclear arsenal would harm the nation’s international prestige and status. As they see it, if Russia allows the current nuclear balance to tilt in the United States’ favor, the world security order will be skewed and Russia’s standing will be degraded to the level of the United Kingdom or France. An additional fear of the ministry might be that knowledge of this internal conflict would give the United States a stronger position in negotiations and a “calling card” for deeper involvement in a variety of security issues throughout the world — circumstances not in Russia’s best interest.

Responses to the debate by the Russian private sector were clearly divided. Virtually all strategic analysts, from the ultra-patriotic newspaper *Zavtra* to the *Yabloko* liberals, almost unanimously supported Sergeyev’s point of view. Their position can be explained partly by the fact that the

7 The ratio of financing between the strategic nuclear forces and general purpose forces will be approximately 1 to 3. “Nachat novyi etap reformirovaniya armii,” *Oborona i Bezopasnost*, Vypusk No. 96, August 8, 2000; “L’arme russe perdra 350,000 hommes d’ici 2003,” *Le Monde*, September 11, 2000.

vast majority of civilian experts in the field of security have spent their entire careers working on problems of nuclear strategy and strategic stability during the Cold War. Quite expectedly, they sought solutions in that context rather than in a framework of a changing world.

Three principal criticisms against de-prioritizing nuclear deterrence emerged from Kvashnin's opponents. Firstly, opponents accused him of attacking Russia's status as a great power. For them, the number of nuclear weapons itself holds as much significance and status as the number of symbols surrounding the hut of a tribal chieftain. Therefore, they argue it's necessary to maintain Russian strategic weapons at a level commensurate with the current balance while upgrading C4I and early warning systems. What they view as most important is the creation of a uniform system of operative management of all nuclear forces in Russia, abolishing all redundant structures while enhancing efficiency and response.⁸ Sergei Rogov, Director of the USA/Canada Institute in Moscow, amplifies this argument. He believes that in order to warn the United States, who he sees as actively aspiring to change the world military balance in its favor, Russia must take rapid measures for preserving the strategic balance such as announcing the testing of "Topol-M" systems armed with multiple individually targeted warheads.⁹ Kvashnin's opponents' second and more concrete argument is that his plan "undermines Russia's ability to maintain a nuclear balance and allows the Pentagon to plan a pre-emptive counter-force strike, thus avoiding a nuclear missile retribution."¹⁰ In short, they believe his plan disarms Russia and places it at the United States' mercy.

Finally, in keeping with the deterrence mindset, the third argument subscribes to the theory that the Russian Federation's dependence on nuclear weapons is not only a means of preventing a nuclear strike but also a way to prevent aggression from adversaries who have conventional forces more

8 Last year, Sergeyev proposed establishment of a general command to unify the control structure of all nuclear forces. This plan, if implemented, would have reduced the influence of the General Staff over nuclear weapons.

9 Sergei Rogov, "Strategicheskiy Kapitulyatsiya: 'Plan Kvashnina' i yadernaya politika Rossii," *Nezavisimaya Gazeta*, July 26, p. 1.

10 Vladimir Yakovlev: Sud'bu raketnykh voina opredelit politicheskoe reshenie," *Izvestiya*, July 5, 2000, p. 1.

powerful than Russia does. Sergeyev and his entourage tried to give these positions relevance by developing a doctrine that emphasizes maintenance of the nuclear arsenal to maintain international influence during periods of domestic vulnerability. Sergeyev's strategy, however, was significantly undermined by NATO's air campaign in Kosovo and Russia's war in Chechnya that demonstrated the importance of maintaining conventional military forces.

For their part, Kvashnin and his supporters argue for a great power strategy rather than a superpower strategy. Instead of projecting power globally, they seek the ability to project power regionally. A great power can defend itself from all neighbors and project power along its frontiers and even, to some extent, beyond, as Germany and China can.¹¹

In taking this position, Kvashnin's faction also argues that nuclear weapons are irrelevant to the actual correlation of forces. The ability to launch a first strike against the United States is devoid of meaning, since there is no foreseeable political circumstance under which such a strike would be contemplated. Moreover, if nuclear deterrence must be maintained, it does not require massive capability. A much smaller force, on the scale of France or Israel, is sufficient.¹²

Under Russian doctrine, one of the roles of nuclear weapons is to repel an overwhelming conventional attack which might necessitate first use. But Kvashnin's supporters argue that the threat of attack from the West can be deterred at a much lower level. The failure of the military phase of the Kosovo operation, and the NATO countries' lack of readiness to deploy ground forces, showed once again that for these countries, "unacceptable damage" amounts to losing just a few tens of soldiers. Furthermore, the nature of the threats on Russia's southern borders is such that they simply cannot be deterred or dealt with by nuclear weapons. From their perspective, relying on nuclear weapons even in a potential conflict with China is both illusory and irresponsible.

11 "Superpower vs. Great Power: Inside the Russian Defense Debate," *Stratfor.com*, July 17, 2000.

12 Andrei Piontovsky, "Season of discontent: Kvashnin and the experts," *The Russian Journal*, August 19-25, 2000; "Superpower vs. Great Power: Inside the Russian Defense Debate," *op. cit.*

The modifications made to the military reforms plan by the Security Council on August 11 betrayed the illusion of Russia’s “superpower” status and telegraphed the reality that Putin’s Russia has stepped down to “great power” standing. This realistic approach could have been taken only after the Security Council recognized, despite great reluctance, that the conventional forces were rapidly deteriorating due to extremely limited financing even while the military threats that should be parried by these troops were increasing.

While the Security Council stepped forward with these recommendations, they did not do so in a vacuum. Rather, these reform initiatives represent the confluence of actors that shape Russia’s security policy. To understand this process we must define the Russian Federation’s main players in the national security policy-making process and examine the influences of Russian domestic politics on security policy formulation.

Major Actors in the National Security Policy-Making

Today, the Russian Federation, like any other country in the world, cannot formulate its own security policy without being conditioned by domestic factors. Governmental and non-governmental forces are particularly relevant to policy formulation, whether it remains a superpower or not. These include the president, the Duma, the military-industry complex (VPK), and the civilian security experts linked with the mass media. It goes without saying that although non-governmental forces have the potential to affect policy, they share a common handicap in the sense that they have no formal policy-making authority. Thus, to influence policy, they must work through official actors, such as the president, the Duma, and the military.

President of the Russian Federation

For the first time in Russian history, power was transferred from one head-of-state to another by a legitimate democratic process. This partly explains

why the President is more powerful than any other institution in Russia today. Putin has already exercised his role as Supreme Commander in Chief by exerting his will over the military's on security policy. Soon after having been officially inaugurated as president, he declared, "Defense capability should be a priority of our state."¹³ His statement is noteworthy in light of the fact that post-Soviet Russia has not yet had a coherent national security policy. Former president Boris Yeltsin neglected national security on the premise that rebuilding the national economy took priority. Investment in national security was deemed counter-productive and anachronistic.

In contrast, President Putin called for the modernization of the armed forces to become a key government priority, saying it was necessary to ensure stability in Russia. He stressed that the Russian military needed to be prepared to handle domestic threats, such as rebels in Chechnya, and external ones, such as international terrorism or the perceived threat from the West.

One of the first things Putin did when he became acting head of state was to meet with the heads of the security ministries every Monday. This was in response to the situation in the North Caucasus. Nevertheless, President Putin's response to the public quarrel between the highest-ranking generals last July was quick and clear. It is important to note that the president shut down the debate after Sergeyev went public, not immediately after Kvashnin's comments. Moreover, the world has had a ringside seat to a Putin-led historic revision of the future direction of military reforms. Like all of Putin's undertakings connected with the country's political and social reconstruction, military reform in all likelihood will be a radical one. Clearly the president is setting the stage for a "great power strategy."

The Duma

The Duma has become one of the most important actors in the formulation of national security-military policy. The Duma is not a single institution; one can examine the Duma through many lenses: parties, committees,

13 Anna Dolgov, "Military factor 'vital' for Russia, Putin says," *The Associated Press*, http://www.russiajournal.com/start/defense/article_72_3321.htm.

leadership, and individual members. Of all these, it seems that the most powerful administrative unit related to national security policy is the Defense Committee.

For example, Igor Sergeyev has achieved much more in his office as defense minister than simply a numerical reduction of the armed forces because of his working relationship with the Duma's Defense Committee. By accomplishing the first-stage tasks of military reform, he has tried to optimize all of Russia's security forces, including non-MOD services, to achieve greater efficiency and a considerable reduction in expenses. These efforts were supported by the Defense Committee. In addition, Sergeyev has actively supported efforts by the Duma to move toward greater civilian control of the military and increased transparency in the defense budgeting process. Here it is important to note several significant changes in the Duma Defense Committee that took place over the last few years. With the participation of retired General Eduard Vorobyev, Aleksei Arbatov, and others, the Duma Defense Committee achieved greater transparency in the defense budget, established a good working relationship with the defense minister and the MOD in general, and passed important legislation on military reform. Importantly, the law on budget allocations requires the government to present a very detailed budget plan for approval by the Duma. Consequently, the Duma now has a very strong voice even in shaping certain military programs where that opportunity was previously denied.¹⁴

In short, civilian control of the military is minimal but a growing priority in Russia. Today the Russian military is under presidential, not civilian, control. Attainment of full civilian control of the military is still in its infancy and controlling civilian legislation remains "very raw," according to retired General E. Vorobyev, a Duma Defense Committee member. Importantly, however, the notion of civilian control of the military is now widely accepted in the Communist-dominated Duma and

14 Walter Parchomenko, "The State of Russia's Armed Forces and Military Reform," *Parameters*, Winter 1999-2000, pp. 98-110.

among political leaders in general. The fact that the major Duma parties advocate the boosting of military expenditure provides proof of this.¹⁵

Military Industry Complex (VPK)

Russia is home to an emerging collection of special interest groups. Still, lobbyists and lobbying groups have a very limited capacity in affecting the odds of whether a policy will be defined and adopted. This is not to say that groups have little influence on politics. They obviously have considerable clout and this is particularly true in regards to the military industry complex. Although the latter's influence may be exaggerated in the press and by analysts, the fact remains that virtually every decision made in Russian security policy affects armament manufacturers. Increasingly, this affected group is becoming cognizant of the complex machinations inherent in important governmental decisions and is endeavoring to involve itself in the process. Furthermore, Russia's VPK deepened and extended its influence in recent years, since arms sales are one of the new Federation's best industries for earning hard currency.

Although Russia's defense industry, along with other sectors of the economy, plummeted following the 1991 collapse of the Soviet Union, it is slowly building its way back to influential levels. By one estimate, defense exports plunged from a value of \$31.2 billion in 1987 to \$2.8 billion in 1992. The figure for 1999 is known to be \$3.4 billion, while the

15 As the Russian government crafts a budget for 2001, citing not only the Kursk incident but also Putin's own promise to strengthen the armed forces, politicians are taking on the fight usually waged by military leaders. Members from the three most powerful parliamentary groups, as well as the Duma Defense Committee, have called for defense spending higher than the \$7 billion (2.6 percent of GDP) currently planned for 2001. General Andrei Nikolayev, chairman of the Duma Defense Committee, is leading the rally, asking to increase the draft budget to approximately \$9 billion. The Communist Party, led by Gennadi Zyuganov, wants to see at least 3 percent of the GDP spent on defense. And Fatherland-All Russia, as well as the pro-Kremlin Unity bloc, also agree that the defense budget needs a boost. "Russia: Military Quiet as Leaders Wrangle over Balanced Budget," *Stratfor.com*, September 19, 2000.

figure for 2000 is \$4.3 billion, with Asia accounting for about half of these deliveries.¹⁶

The defense sector comprises some 1,700 enterprises including manufacturers, design bureaus, and research institutes. Russian planners have argued that these should be reduced to 600 under a rationalization program aimed to improve efficiency. However, funding shortages aggravated by limited domestic procurement hampers reform in this sector. Within this environment, President Putin is viewed as the first Russian leader in years to treat defense sales and the health of the defense industry seriously. Rebuilding Russia's national strength is linked to reforms in the defense industry sector and to the development of a new generation of major equipment and technologically advanced systems. In order to institute an optimally effective policy for the promotion of the VPK, it is necessary for the Russian military to depend more on selling conventional armaments than nuclear defense systems, which are essentially prohibited from earning hard currency.

The Mass Media and Security-Military Experts

Much of what most Russians learn about the world and their national security policy is disseminated by the mass media. In Russian society today, with its longing for openness and transparency, the mass media plays important roles that can influence the conduct of Russia's security policy. Although President Putin declared in his July 14 press conference that "such decisions (on the reorganization of the Strategic Missile Forces) cannot be made privately, but they cannot be put for nation-wide discussion, either," this issue has been open to public scrutiny from the civilian strategic experts to the ultra-patriotic newspaper *Zavtra* and *Yabloko* liberals.

16 The former Soviet Union used arms transfers and military assistance as a political instrument against NATO and other Western forces during the Cold War. This meant that its 1990 defense exports of \$16 billion generated only \$900 million in cash. With the political imperative of favoring countries of military support now gone, Russia's defense industry is struggling to find its way in a global market. Damian Kemp, "Russian industry hunts out a future for itself," *Jane's Defence Weekly*, February 29, 2000.

It is true that the influence of the media is not likely to be the same in all circumstances. It tends to be greatest when the domestic political dimensions of a security-related issue become a major concern of the public. In this context, the debate over the future of the strategic military forces was unusual enough to focus the public's attention on national security policy.

It is also worth giving attention to what has been written by security and military experts on reform. In numerous articles and columns, they shaped and constructed the arguments and logic upon which both Sergeyev and Kvashnins' supporters based their views. This conceptual confrontation between civilian security experts, then, serves to illuminate and define policy positions.

For example, Rogov insists that only the reinforcing threat of a rapid increase in Russia's strategic nuclear forces will fortify its position in negotiations with the United States on the START-III and ABM treaties.¹⁷ In counterpoint to this conservative view, expert Andrei Piontkovsky is joined by Peter Felgenhauer, senior defense columnist, who defines Russia's armed forces today as, at best, a militia. They explain that instead of spending scarce rubles on more new ICBMs, Russia should spend more on modern conventional weapons such as night ground-attack aircraft and helicopters with thermal imaging equipment to deal with regional threats in the Caucasus and elsewhere, and also on the social safety net for downsized and active military personnel.¹⁸

National Security Policy and Domestic Factors

National economic performance. After more than a decade of virtually uninterrupted decline, the gross domestic product (GDP) grew 3.2 percent in 1999. This recovery was primarily attributable to the import substitution effect after the devaluation of August 1998, the increase in unit value

17 Sergei Rogov, "Strategicheskiy Kapitulyatsiya: 'Plan Kvashnina' i yadernaya politika Rossii," *op. cit.*

18 Parchomenko's interview with P. Felengauer, see W. Parchomenko, "The State of Russia's Armed Forces and Military Reform," *op. cit.*

of Russia's oil exports, and some industrial and financial restructuring. The GDP is expected to grow by 4-5 percent in 2000, and by an average of 3-4 percent in 2001-2005, spurred by increased investment and an upturn in consumption.¹⁹ Nevertheless, for recovery of its international status, Russia's lack of funds is still the most difficult weakness to be overcome.

Because of this fundamental economic weakness, the defense budget remains wholly inadequate given the army's size and needs. The total 1999 defense budget was only about \$4 billion and provided six times less than the minimum funding needed for adequate combat training.²⁰ The current defense budget also does not tackle the military's outstanding debt problem, which is massive (close to the total defense budget) and still growing. Such a debt significantly undermines the general health of the country's economy and further damages the military's prestige. According to the General Staff, the debt to the military is more than 60 million rubles. Furthermore, over the past three years, only individual weapons purchases have been made, with most of the funds allocated being wholly consumed to pay for wages, food, and uniforms. A situation has arisen in which whole branches of the military have been starved of funding. The army is so catastrophically short of operational equipment and funds that to execute operations in the North Caucasus requires a combined funding effort from all regions and fleets.²¹ This serious lack of funds exposes the contradictory nature of the recent Russian doctrine that relied on the threat of nuclear weapons to compensate for a weak army.

The troops need to support themselves and their families long ago surpassed the importance of loyalty and minimized sense of nationalism.

19 Jeff Thomas, "The Russian Economy in July 2000," *Russian and Eurasian Program*, Center for Strategic and International Studies (CSIS), July 17, 2000; Sun-sup Park, Kyong-wook Shim et al, "Trend of Military Capabilities Development in the North-East Asian Powers: 2000-2020," Korea Institute for Defense Analyses (KIDA), Research Paper to be published in December 2000.

20 *Izvestiya*, February 9, 1999; W. Parchomenko, "The State of Russia's Armed Forces and Military Reform," *op. cit.*

21 Vladimir Mukhin, "Public row over, but what's in store?" *The Russia Journal*, July 29-August 4, 2000.

According to numerous reports, soldiers steal, bribe, and engage in extortion to fund themselves. Sporadic corruption would not be crippling, but when it occurs en masse and consistently as it does in Russia, it undermines morale and saps the military of what little resources it holds. The corruption plaguing the ranks of the Russian military stems from the pervasive feeling among Russian troops that they are being cheated. Soldiers earn an average of about US\$50 a month, and have not yet received the substantial raises they were promised. Often, troops are not paid nor rationed food. In January 2001, servicemen expected a 10 percent raise, less than the country's projected annual inflation rate.

Given this environment, Putin's new orientation of national security policy must be rooted in economics. Russian spending power is exceptionally limited. Decision makers must thus choose a singular strategy focused on regional — not global — influence. This strategy clearly demands an emphasis on conventional forces. Concurrently, spending money modernizing a conventional force would involve development of new technologies in fields such as communications, computing, and logistics, all of which would have a major stimulating effect on the Russian economy. Concomitantly, the development of a more technologically advanced force will allow the Russians to reduce the military to a more manageable and affordable size that would in turn free funds for much-needed training and modern conventional weaponry.

Social consciousness on national security. Recent international events such as NATO intervention in Kosovo gave greater public emphasis to Russia's "spiritual renewal" and "moral values, traditions of patriotism" as well as the social consciousness on national security. This process of the recovery of national identity stems from the Russians' humiliation by NATO's expansion, the chronic economic crisis, the Kosovo conflict, the West's interference in the Chechen war, and the United States' attempt to revise the ABM treaty. All were interpreted as direct threats to future Russian sovereignty and regional influence. All served as stern reminders to the Russian people that the Russian nation must move forward under the new president to revive the notion of national identity.

The awareness that Russia is faced by external as well as internal threats is conspicuous to Russians. This renewed interest in national security issues provides the general officers on the General Staff with the opportunity to plunge towards a more realistic approach. Moreover, their desired initiatives to modernize and develop an effective modern conventional force is narrowly linked to the latent and unusual security threats mentioned hereafter.

Demographic decrease. Recent State Statistics Committee's monthly reports on Russia's socio-economic situation state that Russia's death rate is almost twice as high as its birth rate. At the current rate of decline, Russia's population shrinks by about 2,500 every day. If Russia's birth and death rates stabilize at current levels, Russia's population in 2050 will be a mere 116 million.

Russia simply lacks the basic health infrastructure to maintain its population. Diseases, such as tuberculosis and syphilis, are increasing. Russia's suicide rate is now 40 per 100,000, one of the highest in the world. The number of reported alcoholics in Russia has doubled since 1992 to reach 2.2 million. More than 110,000 of these alcoholics are aged 12-16. Even the most basic social unit — the family — is in decline. From January 1999 to January 2000 the number of marriages decreased by 5 percent and the number of divorces increased by 23 percent. About 70 percent of all pregnancies since 1994 ended in abortions. Partly because of this high abortion rate, one in five Russian couples are now infertile. Clearly the country must adjust to having fewer people and cannot view population as a resource.

Demographic collapse will exacerbate nearly every other problem Russia faces. But Russia's greatest challenge remains strategic. Already Russian commanders are voicing concerns about difficulty in manning Russia's army. Sergei Ivanov, the secretary of the Security Council, states that "in 18 years' time the number of people due for military service will drop in half, from 850,000 to 450,000."²² As the 21st century progresses,

22 "Russia's Dwindling Population Ensures Rigid Foreign Policy," *Stratfor.com*, April 13, 2000.

Russia's traditional strategy, based on numerically superior manpower, will be less and less feasible.

During the latest conscription cycle, 33.4 percent of all potential conscripts were ruled out from the start on health grounds.²³ More than half the conscripts sent to the army today suffer from various kinds of illness that limit their capacity for military service, and with every year, the number of unfit conscripts is increasing. Over the last three years, the number of conscripts deemed fit for military service has dropped by 4.8 percent. In such conditions, since 1997, the number of conscripts exempted from service has increased steadily and now surpasses the number of those actually sent to serve.²⁴

Secessionist tendencies. Putin was right when he implied more than once that the most important external threat is that coming from the South: Islamic extremism threatening Caucasus and Central Asia.²⁵ These areas are the only regions experiencing a "demographic explosion" while showing disdain for and often rejection of Moscow's governance.

Lacking manpower, a prudent course for Russia is to attempt to offset quantity with quality. However, as discussed above, Russia lacks the money to fund the technology for such a transition. And, as explained, Russia simply does not have the population to defend itself against expanding neighbors while thwarting separatist movements. Specifically, Russia fears an expanding NATO to the West; hence Russia's belligerent statements against the inclusion of the Baltics in NATO. Russia also faces growing Islamic radicalism to the South; hence its desire to lash the Central Asian states together in a pro-Russian grouping. Another threat seems to be Chinese migration (and growing influence) into the Russian Far East. Russia's desire for a political alliance barely eclipses the security

23 Even in Russia's wealthiest city, almost one-third of Muscovites of draft age have been deemed ineligible for the draft for health reasons.

24 Vladislav Komarov, "Russia's Army still mired in conscript crisis," *The Russia Journal*, Issue 58, June 2000.

25 Francois Bonnet, "Vladimir Poutine veut engager une forme radicale des forces armées," *Le Monde*, aot 15, 2000, p. 1.

fears caused by large numbers of Chinese migrants, who account for a majority of the population in some sections of the region.²⁶

This sense of being besieged is keen. It is no wonder that Russia is seeking to make an example of Chechnya. The operation is instructive; future internal threats will be dealt with as harshly. To successfully counter these threats with a shrinking reservoir of personnel, Russian security policy must become even more unyielding. This manifestly constitutes the salient reason why Russia has revised its security policy, depending more upon the non-nuclear guarantors of territorial integrity.

Russia's threat of a nuclear strike is effective in bolstering Russian nationalism, forcing the West to consider its actions, and reminding Russia's neighbors of their relative strategic military inferiority. This capability, however, does not work against regional terrorists and domestic separatist groups. Nor does it enable Russia to deploy peacekeepers or wield any practical regional influence or control in an emergency.

Conclusion

Within this complex security milieu, the finalization of the “to be or not to be a superpower” debate will be constrained by the political propensity of the young president. It is necessary to note that breaking the last link with greatness would expose Putin to the charge of having finally turned Russia into a Third World nation, as Gorbachev did in a different way. In office only a few months, Putin initially found himself in a tough position in this debate — open to nationalist allegations that he was catering to the United States’ interests. Instead, he rapidly adopted the regional great power strategy and did so only by placing himself at political risk. In this controversial and strategically important debate he showed the world and

26 Some high-ranking officials including Yuri Baturin and Valeri Manilov, are warning that a Chinese population invasion has already started. Colonel-General V. Manilov, “National Aims of Russia and Threats to Its Security,” *Military News Bulletin*, No. 10, October 1996, p. 16; Valrie Niquet, “La Russie et l’Asie,” *Defense nationale*, October 1996, pp. 45-60.

Russians alike that he could be a decisive, pragmatic-minded, and result-oriented leader.

Putin seems prepared to begin directing the administration's efforts toward a modernized conventional military. His recent orders have called for the marginalization of Russia's once powerful nuclear forces in favor of a more professional conventional force. For the moment, Putin can use the Soviet nuclear cache as a security umbrella for the next few years until Russia's conventional force has received its desperately needed refurbishment. By then the START III treaty could be in effect, putting Russia on equal nuclear terms with the United States, with each country allowed between 1,500 and 2,500 warheads.

However, in adopting a more realistic policy, presidential control is not the preferred end. Comprehensive and organized support from the Duma has been and continues to be singly important in paving the way for support from the Ministry of Foreign Affairs and the military. Putin could not have pursued his policy initiatives without extensive cultivation of the mass media and an accompanying public relations campaign prosecuted by like-thinking civilian security-military experts. This new security policy was thus formulated with the influence of all these actors, and the same will be true of its future course.

The above considerations give us insight for predicting the changes that may take place in Russia's security policy in the next two decades. First, Russia is ready to abandon its attachment to superpower status in order to maintain a position as a great Eurasian power. This points us to a second important consideration — the recovery of a feeling of security guaranteed by military potency. This is demanded by Russia's inherent paranoia about being besieged by neighbors. In the West, NATO continues to expand into the former Soviet sphere beginning with the Baltic. Also, elements operating in the East include the potential regional hegemony of China awakening from a centennial slumber and Japan's rearmament, while in the south secessionist trends in the Caucasus and fundamentalism in Central Asia and Middle Asia continue to pose challenges for Russia.

As Putin argues, Russia's most immediate security threat may very well be within or adjacent to Russia's borders, not from the West or across

oceans. To ensure its security, the territorial integrity of the Russian Federation must remain within Moscow's control. This means secessionist tendencies, both current and projected, in places like Chechnya and the Far East must be suppressed. Russia must also be in a position to defend its frontiers and territorial waters. Russia must create a force capable of this charge within the constraints of the Russian economy, placing limits on what Russia can do in the immediate future. These security challenges can only be achieved by pursuing a strategy such as Putin's regional great power doctrine. By modernizing and boosting the capability of its conventional forces, Russia can gain enhanced economic benefit through conventional arms sales and minimize its demographic crisis. This is the course that best preserves Russia's limited influence and maximizes its limited resources without compromising internal security. There is no doubt that this is the policy Putin has chosen to proffer and garner support from key actors for. Whether it comes to fruition remains to be seen.

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Cross-Straits Security Relations: The Role of Domestic Politics in the PRC and Taiwan¹

Yasuhiro Matsuda

Introduction

Cross-strait relations have become highly militarized since the middle of the 1990s, and they cast their shadow over the peace and prosperity in East Asia. As Taiwan becomes more democratized and independent from the People's Republic of China (PRC), the PRC applies military pressure toward Taiwan to try and intimidate it. But then the United States opposes the Chinese action and supports Taiwan's national security. Then Taiwan feels safer, and behaves more autonomously. This in turn makes the PRC upset, and it strengthens its military threat against Taiwan. It seems that no one can stop this vicious cycle, although no one wants it. However, after

1 This paper is one of the products of the joint research program which was conducted by the National Institute for Defense Studies (NIDS) and the Asia-Pacific Center for Security Studies (APCSS) in 2000. However, the opinions expressed herein are those of the author and not necessarily reflect those of NIDS or APCSS.

the pro-independence politician Chen Shui-bian was elected in 2000, this cycle has changed its nature.

What generated this vicious cycle? Why has the cycle changed in 2000? Is the new cycle sustainable or not? The purpose of this paper is to try to answer these questions by addressing some important factors of domestic politics closely related to cross-strait security relations in both the PRC and Taiwan. As the end of the Cold War reduced pressure from the global system and gave both sides larger room for domestic political changes, the domestic politics can help us better understand the mechanism of destabilization of cross-strait relations. Differences of core values, social settings, and political process in the PRC and Taiwan are discussed first, then the new cycle of relations under President Chen Shui-bian and future prospects are considered.

Core Values

There are three elements of “core values” that need to be discussed: different interpretations of history and nationalism; changing nationalism; and democracy and human rights. These elements complicate the cross-strait dynamic.

Different interpretations of history and nationalism. It is extremely difficult for people who have been separated and hostile in the past hundred years to share the same understanding of their history. In turn, there are different emphases in nationalism arising from the differences between the PRC and Taiwan in interpreting history and nationalism.

China lost large amounts of territories during the age of imperialism, and the Chinese are taught that China was one of the most miserable victims of modern history.² Thus, it is felt, compromise on sovereignty issues would amount to a betrayal of the “great Chinese history,” like the

2 With regard to the Chinese view of history, see Ketsu Ryuu, (Liu, Jie) *Chuugokujin no Rekishikan, (The Chinese View of History)* Tokyo, Bungei Shunjyuu sha, 1999, Chap. 2.

one in the Qing dynasty and the Kuomintang era. Therefore, unification of China is the most precious value and the national goal for Mainland China; no one in China can explicitly resist this goal.

On the other hand, “the rule of Taiwan by the Taiwanese themselves” is a dream for the native Taiwanese. The native Taiwanese tend to think that they have been ruled by people from abroad such as the Dutch, the Spanish, a refugee government of the Ming Dynasty, the Qing Dynasty, the Japanese, and the Kuomintang. Therefore, native Taiwanese tend to think that ruling the island by themselves is not an easily obtainable goal. The native Taiwanese people embraced Lee Teng-hui because he was the very first native Taiwanese leader in Taiwanese history.³

The nationalism of the mainlanders in Taiwan has its origin in the war with Japan, which is as same as the one in the PRC. However, the mainlanders in Taiwan identify with political symbols such as the ROC, the Kuomintang, and “great leaders” like Sun Yat-sen and Chiang Kai-shek. Thus, the mainlanders in Taiwan hate and fear the CCP, which defeated the Kuomintang half a century ago.

Changing nationalism. During the 1990s, the nature of nationalism both in the PRC and Taiwan has changed. In the PRC, patriotism is much more emphasized as the legitimacy of socialism was undermined after the Tiananmen Square Incident in 1989. The “Patriotism Campaign” which was mounted under the Jiang Zemin government in 1994 strongly emphasizes the importance and inevitability of the unification of China. The reversion of Hong Kong and Macao aroused nationalism and pressured the PRC’s leadership to “solve” the Taiwan issue.⁴

On the contrary, in Taiwan, support for Taiwan independence and Taiwanese identity have grown rapidly during the 1990s. Taiwanese

3 Masahiro Wakabayashi, *Shoukeikoku to Ritouki: Tairiku Kokka karano Ridatsu?*, (*Chiang Ching-kuo and Lee Teng-hui: A Breakaway from a Continental State?*) Iwanami Shoten, 1997, pp. 183-184.

4 Yasuhiro Matsuda, “Chugoku no tai Taiwan Seisaku: Koutakumin Hachi Koumoku Teian no Keiseikatei,” (*The PRC’s Taiwan Policy: the Making of Jiang’s Eight-Point Proposal*) *Bouei Kenkyu, (Defense Studies)* No. 17, October 1997, p. 24.

nationalism has its origin in anti-Kuomintang sentiment, which in turn has its origin in the failure of the Kuomintang's rule on Taiwan during the first stage of the requisition of Taiwan in the 1940s and 1950s. In other words, the native Taiwanese did not necessarily have strong resentment against Mainland Chinese, despite having had an anti-communism education under the Kuomintang's rule.

However, the PRC has taken many "rude" and "hostile" actions toward Taiwan in the 1990s, such as the Lake Qiandaohu incident in 1994,⁵ missile tests against Taiwan in 1996, and continuous anti-independence propaganda during the following years. Therefore, the target of Taiwanese nationalism has gradually turned from the Kuomintang in Taiwan to the Communists on Mainland China. On the other hand, since Lee Teng-hui promoted the Taiwanization of the Kuomintang, it has become an acceptable political party for the native Taiwanese.⁶ However, the New Party, which has been strongly supported by the mainlanders, and is virtually a peripheral political party in Taiwan, has become the target of Taiwanese nationalism inside Taiwan. Therefore, Taiwanese nationalism has gradually shifted its target from inside to outside Taiwan.

As for the mainlanders in Taiwan, it is not the CCP, but the native Taiwanese who are seen to pose a direct and imminent threat. A nightmare for the mainlanders is that the native Taiwanese will come into power through democratization and Taiwanization, and will oust them from Taiwan. Thus, the pro-independence Taiwanese are the "real enemy" for the mainlanders. However, the Taiwan Strait crisis reminded the mainlanders that regardless of political orientation, people in Taiwan are a nation sharing a common destiny⁷ because ballistic missiles do not have eyes and can kill both pro-independence and pro-unification people. After the crisis, the influence of pro-unification groups in Taiwan weakened, and disappointment and anger against the PRC has become widespread even in the mainland community.

5 *Ibid.* pp. 20-21.

6 Masahiro Wakabayashi, *Taiwan: Bunretsu Kokka to Minshuka*, (Taiwan: Divided Nation and its Democratization) Tokyo, Tokyo University Press, 1992, p. 280.

7 Kenichi Iida ed., *East Asian Strategic Review 1996-1997*, Tokyo, The National Institute for Defense Studies, 1997, p. 130.

Democracy and human rights. Moreover, people in Taiwan think that democracy is more important than unification with the PRC. Taiwan has successfully achieved its democratic transition from the Kuomintang's authoritarian rule. During this process, opposition leaders in Taiwan paid a heavy price. For example, both President Chen Shui-bian and Vice President Lu Siu-lien were jailed for several years due to their political beliefs. It is widely believed that Chen's wife became physically handicapped as a result of a terrorist car attack by the secret service of the Kuomintang.

Democracy has taken root in the Taiwanese soil, and the human rights situation has greatly improved. Taiwan cannot promote a relationship with the PRC at the cost of democracy and human rights in Taiwan. This has become the minimum consensus in Taiwan. In other words, no Taiwanese leader wants to become a "traitor" to the Taiwanese people and their history of democratization.

The PRC's present Taiwan policy is "one country, two systems." This policy's precondition is that the dictatorial Kuomintang chooses cooperation with the CCP in order to preserve its power in Taiwan by avoiding democratization. However, democratization is supported by native Taiwanese and the United States. In other words, this policy is a formulation of the "dictator's coalition" between the CCP and the Kuomintang for a greater China. The PRC apparently pursues national unification without commitment to the introduction of democracy. Having witnessed Taiwan's democratization, one can easily understand that this policy is out-of-date.⁸ Yet, as stated above, if the PRC's leadership abandons or delays the process of national unification, it will amount to a "betrayal" of the "great Chinese history."

In essence, the confrontation between the PRC and Taiwan is caused by fundamental differences in core values such as nationalism, democracy, and human rights. The leaderships on both sides of the Taiwan Strait can never accept policies that "betray" their own history.

8 Yasuhiro Matsuda, "Chugoku no tai Taiwan Seisaku: Koutakumin Hachi Koumoku Teian no Keiseikatei," (The PRC's Taiwan Policy: the Making of Jiang's Eight-Point Proposal) *Bouei Kenkyu, (Defense Studies)* No. 17, October 1997, pp. 5-7.

Social settings

Two domestic factors, national integration and ethnic conflicts/friction amid change in generational and ethnic composition, explain the deterioration of cross-strait relations but could also put a brake on the cycle of deterioration.

National integration and ethnic conflicts/friction. The first point is that national integration or ethnic conflicts/friction play different roles in the PRC and Taiwan.

The PRC cannot but take a hard-line on the issue of Taiwan's independence for the sake of its own national integrity. For example, the Tibetan, the Uighur, the Tajiks, the Kirghiz, the Mongolian, and even the Korean minorities in the PRC are either engaged in separatist movements or are requesting a higher level of autonomy. If the PRC acquiesces in Taiwanese independence, it would be confronted by stronger challenges from separatist movements elsewhere.⁹ Hence, the PRC's tough position toward Taiwan.

On the other hand, the Taiwanese government tends to take moderate positions toward the mainland. There is potential ethnic friction between the mainlanders and the native Taiwanese in Taiwan. This friction originates in the Kuomintang's dictatorship in the past. The Kuomintang and its government were run by the mainlander elites who were a minority in Taiwan's society. Thanks to democratization, the composition of the Kuomintang has been Taiwanized. Although the native Taiwanese have taken over the presidency, vice presidency, most of the main cabinet, and legislative positions, the mainlanders, who basically share the same type of nationalism with the people in the PRC, still occupy major positions in the military, ministry of foreign affairs, and mass media.

9 Even the PRC's "one country, two systems" policy prompted strong request for the "higher level of autonomy" by the Dalai Lama in the Tibetan refugee government. Kazuko Mouri, *Gendai Chuugoku Seiji, (Contemporary Chinese Politics)* Nagoya, Nagoya University Press, 1993, p. 133.

For example, only one sixth of the generals in the Taiwanese military were native Taiwanese in 1997, although native Taiwanese constitute more than 87 percent of the whole population on the island.¹⁰

Therefore, if the government in Taiwan takes either an uncompromising anti-unification or pro-independence stance, national security could be endangered inside Taiwan. In other words, the mainlanders may become “the Trojan horse” in Taiwan, if Taiwan explicitly declares independence.

Generational and ethnic composition. The second point is that change in generational or ethnic composition plays different roles in the PRC and Taiwan.

In the PRC, a big generational change may occur within ten to fifteen years. During the 1990s, those who studied in Soviet Russia during the 1950s ruled the PRC. Young elites from the 1960s and 1970s are the so-called “lost generation,” because they did not have a chance to get a higher level of education inside or outside of the country during the era of Sino-Soviet rivalry and the Cultural Revolution. It was not until the 1980s that the first generation of the elite in contemporary China went to study in the United States and Europe.¹¹ This generation will be promoted over the heads of the “lost generation,” and will begin to run the country. Meanwhile, the generation which studied in Soviet Russia will be gone in ten to fifteen years.

10 Reportedly, there were 60 native Taiwanese generals of 695 in the middle of the 1990s, or 115 native Taiwanese generals of 600 in the estimated year of 1997. Most of the native Taiwanese generals are major generals and rear admirals. See Su, Jinqiang, “Liening shi Zhengquan Minzhuhua Guocheng de Junzheng Guanxi: Taiwan de Fazhan Jingyan,” (Civil Military Relations of the Leninist Government in the Democratic Transition: Case Studies in Taiwan) in Lin, Chialong and Qiu Zeqi eds., *Lianan Dangguo Tizhi yu Minzhu Fazhan*, (Party-State System in the Both Sides of the Taiwan Strait and Democratic Development) Taipei, Yuedan Chubanshe, 1999, p. 223, and Zhongguo Renmin Jiefangjun Zongzhengzhibu (Liaison Department, General Political Department, PLA) ed., *Taiwan Jundui Jiben Zhengzhi Zhuangkuang*, (General Political Situation of the Military in Taiwan) Beijing, Huayi Chubanshe, [Internal Publishing] p. 101.

11 Approximately 320,000 students have studied abroad, and half of them have studied in the United States from the end of the 1970s to the present. *Shijie Ribao*, (World Journal) July 27, 2000.

On the other hand, U.S. influence on the elite in Taiwan has been very strong for over fifty years. Taiwan has been virtually run by the mainlander technocrats who studied in the United States and Europe from the 1950s, especially in some fields like economic or foreign policy-making.¹² From the 1970s to the 1990s, native Taiwanese elites who had a Japanese colonial education (such as Lee Teng-hui) participated in the government. But few of these Taiwanese elites are present in the new Chen Shui-bian government. The new elite in Taiwan consists of both Taiwanese and mainlanders who hold either indigenous Ph.D. or American or European Ph.Ds.¹³

This trend suggests that the new elite in Taiwan will be even closer to the United States soon, but those in the PRC will need a much longer time to do so. The Taiwanese elite are good at getting support and sympathy from the United States, but the PRC elite will probably have a difficult time in doing so at least for another ten years. The Taiwanese elite will keep co-opting the Americans to preserve its state of independence, and the PRC's elite will have a difficult time accepting it.

Political process

Three broad aspects of the political process in both Taiwan and the PRC directly promote a vicious cycle in cross-strait security relations.

Leadership change and political ambition. In the PRC, President Jiang Zemin was quite ambitious, but failed to take drastic measures toward Taiwan, and thus his Taiwan policy failed. There is no single person in the

12 30.4 percent of the cabinet members had studied in the United States and 22.9 percent of them had studied in Europe in Taiwan from 1950 to 1985. Peng Huaien, *Chaoxiang Gaoceng zhi Lu: Zhonghua Minguo de Neige Jingying*, (The Road toward the High Level: The ROC Cabinet Elite) Taipei, Dongcha Chubanshe, 1986, p. 54. With regard to the "super technocrats" in Taiwan, see Ezra F. Vogel, *The Four Little Dragons*, Cambridge, Harvard University Press, 1991, Chap. 2.

13 With regard to Tang Fei cabinet member's personal history, see "Tang Fei Neige de Yaxiang Gushi," (The Tang Fei cabinet's stories in the cabinet) *Xin Xinwen Zhoubao*, (The Journalist) No. 685, April 20-26, 2000.

PRC who can effectively command the party, the government, and the military after the death of Deng Xiaoping. Jiang Zemin has only inherited and continued Deng Xiaoping's Taiwan policies for the sake of political stability in the PRC. On the other hand, Jiang Zemin, who is not a self-confident leader, has also tried to become more powerful, and thinks that if he solves the Taiwan issue he could enhance his authority and become a legendary leader like Deng Xiaoping.¹⁴ Revising Deng Xiaoping's "peaceful unification" policy, Jiang Zemin released the so-called "eight point proposal" with great fanfare in 1995.¹⁵ But the Taiwan issue was not as easy as he thought. Since Taiwan has already democratized, the PRC needs to gain popular support in Taiwan in order to make Taiwan sit at the negotiating table. Given the huge gap between their core values and social settings, this is an extremely difficult task for the PRC.

Deng Xiaoping, Jiang Zemin's predecessor, clearly understood that a "reform and openness policy," normalization of the relationship with the United States, and a brand-new "peaceful unification policy" were closely connected to each other and were an inseparable policy package.¹⁶ On the contrary, Jiang Zemin's "eight point proposal" was mere tactical cleverness. Jiang Zemin did not dare to try and change or improve the domestic political system, human rights situation, and foreign policy at the same time. Jiang's proposals were not wonderful and attractive for the Taiwanese people at all¹⁷ so Lee Teng-hui could and did dismiss them easily as mere new propaganda. Eventually, a weak leader like Jiang Zemin could not help but resort to the military option in order to save face.

On the contrary, Lee Teng-hui, who is the first indigenous leader of Taiwan, became a powerful figure with a high level of popular support and

14 Yasuhiro Matsuda, "Chugoku no tai Taiwan Seisaku: Koutakumin Hachi Koumoku Teian no Keiseikatei," (The PRC's Taiwan Policy: the Making of Jiang's Eight-Point Proposal) *Bouei Kenkyu, (Defense Studies)* No. 17, October 1997, pp. 23-24.

15 *Ibid.*

16 Yasuhiro Matsuda, "Chuugoku no tai Taiwan Seisaku: 1979-1987," (China's Taiwan Policy, 1979-1987) *International Relations, (Kokusai Seiji)* Vol. 112, May 1996, p. 134.

17 Yasuhiro Matsuda, "Chugoku no tai Taiwan Seisaku: Koutakumin Hachi Koumoku Teian no Keiseikatei," (PRC's Taiwan Policy: the Making of Jiang's Eight-Point Proposal) *Bouei Kenkyu, (Defense Studies)* No. 17, October 1997, p. 23.

successfully implemented the mainland policy by himself. This is because Lee Teng-hui, like Deng Xiaoping in the 1980s, understood perfectly that mainland policy was merely a part of a whole domestic and external policy package. President Lee tried to accelerate the process of democratization, set forth a brand new “pragmatic diplomacy,” and hammered out a new mainland policy.¹⁸ During this process, Lee Teng-hui struggled against the military, old party cadres, and bureaucracy in the government. But due to strong popular support attained through his democratic reforms, he won a victory in the end. In Taiwan, only a strong leader can articulate tougher policies toward Mainland China because potential ethnic friction between the mainlanders and native Taiwanese is such a politically sensitive issue. Lee was such a confident and powerful political leader that he could thrust the PRC away when it came too close to Taiwan.

Role of the bureaucracy and the military. In the PRC, the bureaucracy and the military are merely executing their assignments given the indecisiveness of the leadership. The PRC’s “indecision-making” on Taiwan policy is quite distinctive during the latter half of the 1990s. The famous phrase “We should listen to what the new leader in Taiwan says and watch what he does,” which was used after the presidential elections of Lee Teng-hui and Chen Shui-bian in 1996 and 2000 respectively, is a symbol of the passive and reactive nature of the PRC’s Taiwan policy. In that policy framework the bureaucratic apparatus in the PRC simply continues to accuse Taiwan and the United States through its propaganda apparatus.

The military also has become quite bureaucratic in the PRC. One of the most important goals of the PLA is the unification of China, and the means to achieve its goal is its military capability. Thus, the military simply tends to insist on putting military pressure on Taiwan. Tactically, the military’s attempt has been successful. For example, in 1996, the PLA successfully fired its ballistic missiles right on target and threatened the

18 Masahiro Wakabayashi, *Shoukeikoku to Ritouki: Tairiku Kokka karano Ridatsu?*, (Chiang Ching-kuo and Lee Teng-hui: A Breakaway from a Continental State?) Iwanami Shoten, 1997, Chap. 7.

people in Taiwan. Strategically speaking, however, this tactical success made the United States and Taiwan move much closer toward each other than at any time since 1979. Moreover, the influence of pro-unification supporters in Taiwan was seriously damaged, the “China Threat Theory” has risen rapidly both inside and outside of Taiwan, and the rest of the world sees the PRC as a source of uncertainty in the next century. This tactical success was in many ways a strategic failure.¹⁹

In Taiwan, on the contrary, the bureaucracy was busy supporting and justifying the surprise statement concerning a “special state-to-state relationship” released by President Lee Teng-hui.²⁰ Some politicians and bureaucrats got fed up with the autocratic leadership of Lee Teng-hui, did not want to play the role of a “puppet” anymore, and left the government and the Kuomintang. A few remained in the Kuomintang and are now called the “non-mainstream group,” while others formed the New Party.

The Taiwanese military, in which officers are mostly mainlanders, strongly opposes the independence of Taiwan. Lee Teng-hui’s Taiwan-first policy line has shaken the morale and the political belief in unification with China within the Taiwanese military. According to a report from Taipei, some generals, both retired and in active service are asking, “for whom shall we fight and for what shall we fight?”²¹ Also, a force of F-16 pilots reportedly began job-hopping because of the possibility of a war against Mainland China.²²

Electoral politics/compulsory retirement age. The third point is electoral politics or the compulsory retirement age.

The PRC does not have the same kinds of issues seen in the electoral politics of democratic countries. However, top leaders in the CCP also

19 Kenichi Iida, *op. cit.* pp. 129-130.

20 For example, when Lee Teng-hui released the “special state-to-state relationship” statement, which is well known as the “Two State Theory,” in July 1999, Chairman of the Mainland Affairs Council Su Chi, who was in charge of the mainland policies in Taiwan changed his interpretation of Lee’s statement for several times in two days. *Lian He Bao, (United Daily News)* May 13-14, 2000.

21 *Lian He Bao, (United Daily News)* May 17, 2000.

22 *Lian He Bao, (United Daily News)* May 1, 2000.

have their tenure of office and a compulsory retirement age. Thus, politicians in the PRC also tend to try to solve problems within their term regardless of whether the country is ready to do so or not. In other words, their policies are not checked by the ballot.

On the other hand, Taiwan's electoral politics are very transparent. Given the tremendous pressure from general and local elections, which are held almost every year, politicians in Taiwan are prevented from conducting extreme policies toward Mainland China. In the initial elections during the process of democratization in the early 1990s, politicians in Taiwan proposed some extreme policies to the public, such as the independence of Taiwan. As time went by, however, most of the influential politicians came to avoid extreme policies, and decided to emphasize the maintenance of the status quo for the time being in order to gain wider support from the population. The new title of Taiwan, "Republic of China on Taiwan," which was often used by President Lee Teng-hui, is typical eclecticism combining unification and independence. Chen Shui-bian also adjusted his traditional pro-independence position, hammered out the so-called "new middle line," and successfully won the presidential election in 2000.

Baptized by highly competitive elections, "a happy medium" has become the distinct characteristic of politics in Taiwan in terms of its mainland policy.

The vicious cycle stopped?

Several factors changed the vicious cycle of cross-strait security relations after Chen Shui-bian came into power in Taiwan in 2000.

Chen Shui-bian's self-restraint. After pro-independence politician Chen Shui-bian came into power in 2000, the vicious cycle, which was stated above, has changed its nature. Although the militarization of cross-strait relations seems to have accelerated, in reality both the PRC and Taiwan restrained their military pressure and autonomous activities so that there is neither military conflict nor peaceful dialogue between them at present. Relations have become deadlocked.

Chen Shui-bian did not release a pro-independence policy, but announced a modest mainland policy in his inaugural speech on May 20.²³ He pledged not to declare independence unless the PRC attacks Taiwan; not to rewrite Taiwan's constitution; not to change Taiwan's official name, Republic of China; not to hold a referendum on independence; and not to abolish the National Reunification Guidelines, Taipei's blueprint for eventual reunion adopted in 1991. Holding out the hope for eventual reunification, Chen said: "We believe that the leaders on both sides possess enough wisdom and creativity to jointly deal with the question of a future 'one China.'"

This kind of moderate statement was not surprising at all. Compared to Lee Teng-hui, Chen is a much weaker leader in terms of his institutional power bases. He gained less than 40 percent of the votes, and his party occupies less than one-third of the seats in the Legislative Yuan.²⁴ Therefore, Chen cannot carry out his campaign pledges in domestic policies, although he successfully appointed the Kuomintang retired General Tang Fei as the premier. Moreover, Chen has to control the military, which has been absolutely dominated by the mainlander Kuomintang. Chen cannot ignore this reality.

Since the main component of Taiwanese nationalism was anti-Kuomintang sentiment, Chen's victory over the Kuomintang meant the "virtual materialization of independence of Taiwan." Therefore, it is quite understandable that nearly 80 percent of the Taiwanese people, who include strong supporters of Taiwan's independence, applauded Chen Shui-bian's moderate attitude toward Mainland China after his inaugural speech.²⁵

Stalemate. The PRC is also engaging in self-restraint. Unlike what happened in 1996, the PLA did not carry out any particular military exercises aimed at Taiwan's presidential election in 2000. The reasons

23 *Lian He Bao, (United Daily News)* May 21, 2000.

24 As of the end of November 2000, the DPP occupies only 67 seats of 220 in the Legislative Yuan. Therefore, President Chen can be removed from his office if the opposition parties and independent legislatures stand together for voting for dismissal of President Chen.

25 Poll after Chen's inaugural address revealed that 78.4 percent of the interviewees were satisfied by the address. *Lian He Bao, (United Daily News)* May 22, 2000.

could be that U.S. preventive diplomacy was successful, or the PRC simply could not anticipate Chen Shui-bian's success.

However, the most reasonable interpretation is that the PRC learned a lesson from the tactical success and strategic failures in 1996. The PRC's leadership clearly realizes that it has no military option against Taiwan if the United States intervenes. Instead, the PRC fought a linguistic war. It released a white paper called The One-China Principle and the Taiwan Issue, which states "if the Taiwan authorities refuse, sine die, the peaceful settlement of cross-strait reunification through negotiations, then the Chinese Government will only be forced to adopt all drastic measures possible, including the use of force."²⁶ The PRC Premier Zhu Rongji also "warned people in Taiwan" three days before the Taiwanese presidential election to avoid a war by not choosing a pro-independence candidate.²⁷

At the same time, the PRC demands Taiwan accept the PRC's version of the "one China principle," which is definitely unacceptable for the leaders in Taiwan, as a precondition for restarting cross-strait dialogue. Actually, it is better for Jiang Zemin not to reopen cross-strait dialogue in the short run, because resuming the dialogue simply means that Jiang Zemin helps pro-independence Chen Shui-bian's reelection in 2004. If Jiang Zemin were perceived as a "helper" of Taiwanese independence in the PRC, it would be extremely difficult for him to maintain his political power after the sixteenth Party Congress of the CCP in 2002.

On the other hand, Chen Shui-bian is suffering from the heading of a minority government. He approved Premier Tang Fei's resignation in the beginning of October 2000. The reason for Tang's resignation was not different opinions on their mainland policies, but on the construction scheme of the country's fourth nuclear power station.

The main reason for stalemate in cross-strait relations is that the political leadership in both the PRC and Taiwan is weak: Chen Shui-bian

26 Downloaded from the following web-site. <http://www.fmprc.gov.cn/english/dhtml/readsubject.asp?forefather=000&pkey=20000222171338>

27 *Renmin Ribao Haiwai Ban, (People's Daily Overseas Edition)* March 16, 2000.

has a minority government, and both sides of the Taiwan Strait have difficulty pursuing drastic change in their Taiwan/mainland policies. Both of them are forced simply to buy time.

Conclusion

The purpose of this paper has been to consider important factors in domestic politics both in the PRC and Taiwan closely related to cross-strait security relations, and to analyze the causes of the vicious cycle of the relations. The findings are the following.

First, the difference in core values between the two sides of the Taiwan Strait promoted a vicious cycle in US-PRC-Taiwan relations. The PRC takes a “unification first” position, while Taiwan takes a “democracy first” position. Taiwanese nationalism is gradually targeting Mainland China, while the Great Chinese nationalism is growing as a legacy of socialism being undermined in the PRC.

Second, the gap of social settings between the PRC and Taiwan is so large that it makes both unable to come close and sit at the negotiating table in the short run. The PRC tends to hold a rigid and tough position toward Taiwan; on the other hand, Taiwan takes a moderate position toward the PRC. Taiwan is very good at getting sympathy from the United States, because most of the elite in Taiwan have studied in the United States and are quite familiar with American society. Meanwhile the PRC tends to make the United States upset, and the elite who were educated in the United States will be waiting for promotion to higher government positions for more than another decade. This trend may make relations between the PRC and Taiwan even more difficult in the future.

Third, the weak leadership of Jiang Zemin and strong leadership of Lee Teng-hui resulted in hard-line policies toward each other, and accelerated the vicious cycle in US-PRC-Taiwan relations. The PRC could not catch up with the remarkable political progress in Taiwan. And once Jiang Zemin’s tactical cleverness of firing missiles failed, the military

threat replaced it, and undermined relations with Taiwan and the United States.

Fourth, weak leadership on both sides of the strait made their relations deadlocked. Jiang Zemin neither can resort to the military option, nor “help” Chen Shui-bian by reopening dialogue. Chen Shui-bian cannot step forward to the PRC’s version of “one China principle” for the sake of his political future. After all, both Jiang Zemin and Chen Shui-bian are so busy with their domestic politics that they can do nothing but conduct unilateral monologues.

In the short run, whether the political leadership in the PRC and Taiwan will be strengthened or not is the key to cross-strait security relations in the future. However, since it does not seem that either Jiang Zemin or Chen Shui-bian will be able to become supreme leaders like Deng Xiaoping or Lee Teng-hui, drastic change will not likely occur before the next Party Congress of the CCP and the general elections in Taiwan.

In the long run, if the leadership in the PRC fails to consolidate its power base and promote comprehensive reform, which includes political reform or democratization, it will be extremely difficult for the PRC to normalize its relations with Taiwan. Since the differences in their core values and social settings are so deep, neither the PRC nor Taiwan can sustain stability of relations for long, even if they successfully leave the differences of values on the shelf.

During this unstable transitional era, economic exchanges are the most preferable choice to help manage relations. Taiwan’s investments in the PRC increased 30 percent over the previous year in 1999, despite the fact that other countries are more cautious about the Chinese market. Moreover, both the PRC and Taiwan are likely to enter the World Trade Organization (WTO) at the same time in 2001, and Chen Shui-bian’s government, unlike Lee Teng-hui’s government, supports opening the “three direct links,” which include direct exchange of mail, air and shipping, and trade, with the PRC. If the PRC and Taiwan successfully leave the differences in values on the shelf, and pursue the economic exchanges first, they can coexist and the rest of the East Asia can also enjoy peace and prosperity.

South Korea's Economic Reality After the Financial Crisis and Its Impact on South-North Relations

Yukiko Fukagawa

Introduction

The final year of the 20th century witnessed the historic summit between Kim Dae Jung, the president of the Republic of Korea (ROK) and Kim Jong Il, the paramount leader of the Democratic People's Republic of Korea (DPRK). Since then, positive expectations have emerged for a possible breakthrough in the Korean peninsula's Cold War structure. Many others, however, remain suspicious and uncertain about the prospects of reconciliation. Indeed, as North Korea started to succeed in establishing ties with major Western countries beginning in 2000, basic questions have been raised even in Seoul: What strategy lies behind the DPRK's decision to accept and respond rather positively to the "Sunshine Policy" initiated by the South? How serious is the DRPK about opening and reform? How long can the DPRK manage the external shock of opening its regime? Despite an emotional and nationalistic optimism in the

South, many seem perplexed by the sudden, dramatic reaction from the North. Conservatives in the ROK are even more suspicious and cautious. Others fear a backlash against the “Sunshine Policy” in the latter half of the Kim Dae Jung presidency, when political struggles traditionally increase.

Then, if North Korea changes its strategy unexpectedly, or if the North disappoints the South, or if there is political chaos in the North, can the South abandon the “Sunshine Policy” to go back to a more traditional, conservative policy? The answer seems to be “no,” at least from the economic point of view. After the IMF negotiated reforms, the South Korean economy has become based on a structure substantially different from the past and characterized by three features: thoroughly opened capital market, enhanced market discipline, and more dependence on Chinese market. Hence, the South may have passed the Rubicon in terms of developing a new policy towards the North.

The economic reform after the financial crisis

Capital market opening and direct financing. The most important change in the South Korean economy after the IMF reforms lies in the intensive capital market opening and the rapid shift to direct financing for firms. Traditionally, unlike Thailand or Indonesia, the ROK had preferred strict controls for foreign exchange and had been conservative about capital market opening. It was only in 1993 that comprehensive deregulation and a gradual capital market opening started. Even in negotiating with the OECD for membership, the Korean capital market remained more closed than Mexico and major East European countries.¹ The rational for the slow capital market opening was that the Korean economy would not be able to sustain itself if massive capital flight or speculation occurs as a result of serious conflict with the North. The government was especially careful about short-term capital movements and property market trends. Indeed, this cautious exchange policy and capital market opening helped South Korea avoid

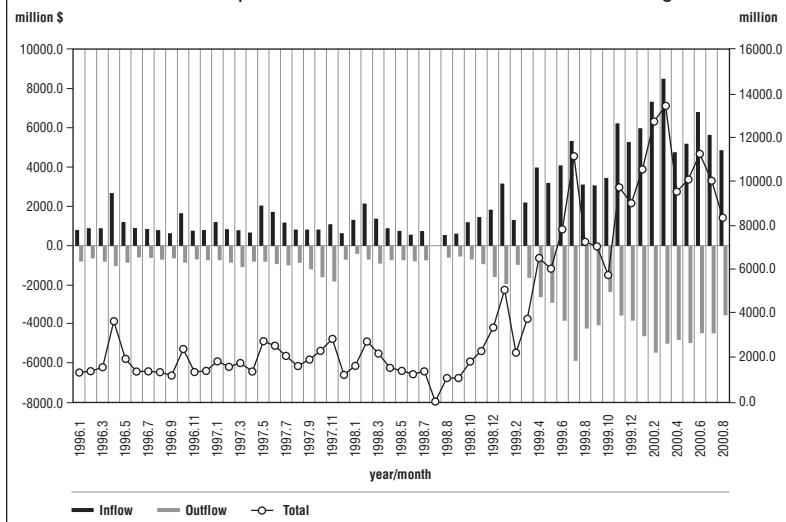
1 For the financial liberalization program in 1990s, see Bank of Korea (2000), or KIEP (1998).

Thailand's bubble economy or Malaysia's problems of speculation by foreigners.

However, to tackle the intensive liquidity crisis, the IMF included rather radical capital market opening as part of the conditionality for the bailout loans.² South Korea agreed to open the stock market fully to foreign investors, including hostile mergers and acquisitions, all the bond markets including the short-term one, and all the property market. Controls on foreign exchange were to be lifted fully in just three years, including Korean residents' portfolio investment and foreign savings, to the level of Hong Kong or Singapore. South Korea has faithfully followed this conditionality and the liberalization program was almost completed in June 2000.

As the capital market was opened, and the vigorous recovery of the Korean economy started to impress investors from late 1999, foreign capital poured into the new market. Table 1 indicates capital inflow and

Table 1 Capital Inflow and Outflow in Stock Exchange



2 It is well known that the conditionality reflected a very detailed demand from Wall Street, leading to the criticism of the so-called "U.S. Treasury-IMF complex."

Outflow and Inflow in Stock Exchange

| | Inflow | Outflow | Total | Balance | KOSPI | KOSDAQ | | Inflow | Outflow | KOSPI |
|---------|--------|---------|--------|---------|-------|--------|---------|--------|---------|-------|
| 1996.1 | 739.7 | -610.8 | 1350.5 | 128.9 | 866.1 | | 1996.1 | 739.7 | -610.8 | 866.1 |
| 1996.2 | 855.9 | -552.1 | 1408.0 | 303.8 | 874.8 | | 1996.2 | 855.9 | -552.1 | 874.8 |
| 1996.3 | 825.1 | -741.5 | 1566.6 | 83.6 | 857.4 | | 1996.3 | 825.1 | -741.5 | 857.4 |
| 1996.4 | 2659.2 | -972.3 | 3631.5 | 1686.9 | 920.1 | | 1996.4 | 2659.2 | -972.3 | 920.1 |
| 1996.5 | 1160.9 | -798.6 | 1959.5 | 362.3 | 942.5 | | 1996.5 | 1160.9 | -798.6 | 942.5 |
| 1996.6 | 879 | -516 | 1395.0 | 363.0 | 867.6 | | 1996.6 | 879 | -516 | 867.6 |
| 1996.7 | 822.4 | -538.8 | 1361.2 | 283.6 | 832.2 | | 1996.7 | 822.4 | -538.8 | 832.2 |
| 1996.8 | 735.5 | -624.9 | 1360.4 | 110.6 | 805.4 | | 1996.8 | 735.5 | -624.9 | 805.4 |
| 1996.9 | 607.4 | -587.9 | 1195.3 | 19.5 | 783.4 | | 1996.9 | 607.4 | -587.9 | 783.4 |
| 1996.10 | 1610.4 | -807.4 | 2417.8 | 803.0 | 806.7 | | 1996.10 | 1610.4 | -807.4 | 806.7 |
| 1996.11 | 718.8 | -633.5 | 1352.3 | 85.3 | 740.9 | | 1996.11 | 718.8 | -633.5 | 740.9 |
| 1996.12 | 754.1 | -665.6 | 1419.7 | 88.5 | 690.6 | | 1996.12 | 754.1 | -665.6 | 690.6 |
| 1997.1 | 1170.3 | -653.5 | 1823.8 | 516.8 | 669.6 | | 1997.1 | 1170.3 | -653.5 | 669.6 |
| 1997.2 | 795.4 | -801.5 | 1596.9 | -6.1 | 698.1 | | 1997.2 | 795.4 | -801.5 | 698.1 |
| 1997.3 | 736 | -1021.2 | 1757.2 | -285.2 | 656.7 | | 1997.3 | 736 | -1021.2 | 656.7 |
| 1997.4 | 615.1 | -738.8 | 1353.9 | -123.7 | 694.3 | | 1997.4 | 615.1 | -738.8 | 694.3 |
| 1997.5 | 2008.4 | -747.3 | 2755.7 | 1261.1 | 713.2 | | 1997.5 | 2008.4 | -747.3 | 713.2 |
| 1997.6 | 1683.7 | -872.6 | 2556.3 | 811.1 | 765.2 | | 1997.6 | 1683.7 | -872.6 | 765.2 |
| 1997.7 | 1147.7 | -932.5 | 2080.2 | 215.2 | 752.3 | | 1997.7 | 1147.7 | -932.5 | 752.3 |
| 1997.8 | 803.2 | -831.7 | 1634.9 | -28.5 | 740.5 | | 1997.8 | 803.2 | -831.7 | 740.5 |
| 1997.9 | 780.8 | -1146.7 | 1927.5 | -365.9 | 676.5 | | 1997.9 | 780.8 | -1146.7 | 676.5 |
| 1997.10 | 749.5 | -1565.5 | 2315.0 | -816.0 | 584.1 | | 1997.10 | 749.5 | -1565.5 | 584.1 |
| 1997.11 | 1057.8 | -1782.3 | 2840.1 | -724.5 | 494.1 | | 1997.11 | 1057.8 | -1782.3 | 494.1 |
| 1997.12 | 577.8 | -654.7 | 1232.5 | -76.9 | 390.3 | | 1997.12 | 577.8 | -654.7 | 390.3 |
| 1998.1 | 1275.9 | -351.8 | 1627.7 | 924.1 | 475.2 | | 1998.1 | 1275.9 | -351.8 | 475.2 |
| 1998.2 | 2101.4 | -631.6 | 2733.0 | 1469.8 | 525.2 | | 1998.2 | 2101.4 | -631.6 | 525.2 |
| 1998.3 | 1345.3 | -863.5 | 2208.8 | 481.8 | 523 | | 1998.3 | 1345.3 | -863.5 | 523 |
| 1998.4 | 843.1 | -695.3 | 1538.4 | 147.8 | 444.2 | | 1998.4 | 843.1 | -695.3 | 444.2 |
| 1998.5 | 699.8 | -698.6 | 1398.4 | 1.2 | 356.3 | | 1998.5 | 699.8 | -698.6 | 356.3 |
| 1998.6 | 513.7 | -723 | 1236.7 | -209.3 | 313.3 | | 1998.6 | 513.7 | -723 | 313.3 |
| 1998.7 | 695.9 | -673.6 | 1369.5 | 22.3 | 327.8 | | 1998.7 | 695.9 | -673.6 | 327.8 |
| 1998.8 | 496.5 | -554.4 | 1050.9 | -57.9 | 312.8 | | 1998.8 | 496.5 | -554.4 | 312.8 |
| 1998.9 | 544.3 | -494.3 | 1038.6 | 50.0 | 312.2 | | 1998.9 | 544.3 | -494.3 | 312.2 |
| 1998.10 | 1140 | -659.8 | 1799.8 | 480.2 | 358.8 | | 1998.10 | 1140 | -659.8 | 358.8 |
| 1998.11 | 1382.1 | -902.2 | 2284.3 | 479.9 | 429.2 | | 1998.11 | 1382.1 | -902.2 | 429.2 |
| 1998.12 | 1772.3 | -1574.1 | 3346.4 | 198.2 | 524.7 | | 1998.12 | 1772.3 | -1574.1 | 524.7 |

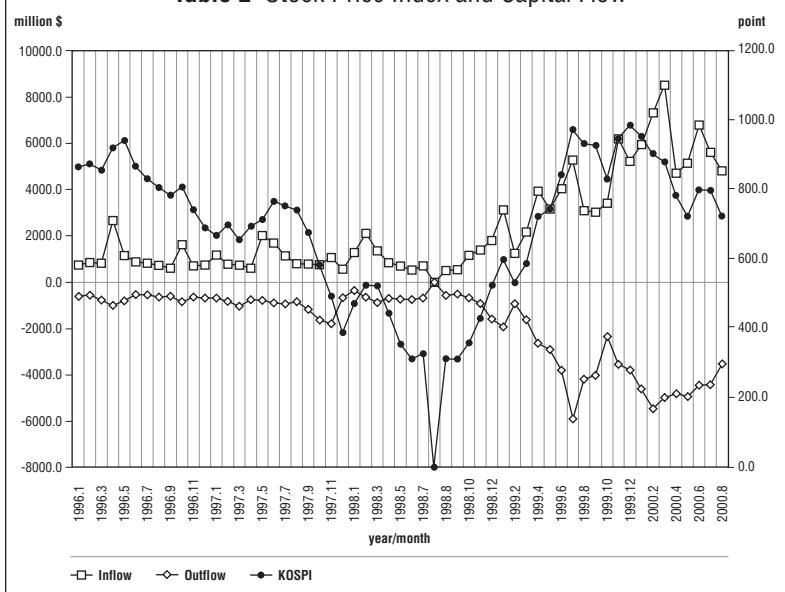
| | Inflow | Outflow | Total | Balance | KOSPI | KOSDAQ | | Inflow | Outflow | KOSPI |
|------------|--------|---------|---------|----------|-------|--------|----------|----------|---------|-------|
| 1999.1 | 3110.6 | -1932.4 | 5043.0 | 1178.2 | 597.6 | 78.18 | 1999.1 | 3110.6 | -1932.4 | 597.6 |
| 1999.2 | 1239.9 | -944.3 | 2184.2 | 295.6 | 533 | | 1999.2 | 1239.9 | -944.3 | 533 |
| 1999.3 | 2130.3 | -1611.3 | 3741.6 | 519.0 | 586.2 | | 1999.3 | 2130.3 | -1611.3 | 586.2 |
| 1999.4 | 3916.3 | -2617.3 | 6533.6 | 1299.0 | 721.1 | | 1999.4 | 3916.3 | -2617.3 | 721.1 |
| 1999.5 | 3135.5 | -2899.7 | 6035.2 | 235.8 | 745.4 | | 1999.5 | 3135.5 | -2899.7 | 745.4 |
| 1999.6 | 4023.4 | -3815.3 | 7838.7 | 208.1 | 841.4 | | 1999.6 | 4023.4 | -3815.3 | 841.4 |
| 1999.7 | 5271.9 | -5889.5 | 11161.4 | -617.6 | 971.4 | | 1999.7 | 5271.9 | -5889.5 | 971.4 |
| 1999.8 | 3058.4 | -4219.2 | 7277.6 | -1160.8 | 933.1 | | 1999.8 | 3058.4 | -4219.2 | 933.1 |
| 1999.9 | 2995.2 | -4049.2 | 7044.4 | -1054.0 | 926.9 | | 1999.9 | 2995.2 | -4049.2 | 926.9 |
| 1999.10 | 3383.8 | -2354.9 | 5738.7 | 1028.9 | 828.6 | | 1999.10 | 3383.8 | -2354.9 | 828.6 |
| 1999.11 | 6181.9 | -3546.7 | 9728.6 | 2635.2 | 950.1 | | 1999.11 | 6181.9 | -3546.7 | 950.1 |
| 1999.12 | 5204.7 | -3817.5 | 9022.2 | 1387.2 | 984.5 | | 1999.12 | 5204.7 | -3817.5 | 984.5 |
| 2000.1 | 5921.8 | -4617.2 | 10539.0 | 1304.6 | 952.5 | | 2000.1 | 5921.8 | -4617.2 | 952.5 |
| 2000.2 | 7290.8 | -5466.2 | 12757.0 | 1824.6 | 902.7 | | 2000.2 | 7290.8 | -5466.2 | 902.7 |
| 2000.3 | 8467.6 | -5005.4 | 13473.0 | 3462.2 | 878.4 | | 2000.3 | 8467.6 | -5005.4 | 878.4 |
| 2000.4 | 4683.3 | -4836.5 | 9519.8 | -153.2 | 779.8 | | 2000.4 | 4683.3 | -4836.5 | 779.8 |
| 2000.5 | 5108.4 | -4966 | 10074.4 | 142.4 | 720.8 | | 2000.5 | 5108.4 | -4966 | 720.8 |
| 2000.6 | 6769.9 | -4481.8 | 11251.7 | 2288.1 | 795.1 | | 2000.6 | 6769.9 | -4481.8 | 795.1 |
| 2000.7 | 5565.4 | -4470.2 | 10035.6 | 1095.2 | 794.1 | | 2000.7 | 5565.4 | -4470.2 | 794.1 |
| 2000.8 | 4789.3 | -3569.6 | 8358.9 | 1219.7 | 720.4 | | 2000.8 | 4789.3 | -3569.6 | 720.4 |
| GNP | | | | | | | | | | |
| 1996 | 520 | 12422 | 12.422 | 2.388846 | 154 | 5998 | 1.538462 | | | |
| 1997 | 476.6 | 12525 | 12.525 | 2.62799 | 11748 | | | | | |
| 1998 | 317.7 | 12810 | 12.81 | 4.032106 | 8822 | | | | | |
| 1999 | 406.7 | 43370 | 43.37 | 10.66388 | 37754 | 5998 | 43752 | 10.76961 | | |

outflow into the stock exchange on a balance of payment basis. After capital market was totally opened, capital inflow grew rapidly to \$14 billion at the beginning of 2000, almost seven times more than the level of the third quarter in 1998. As the volume becomes bigger, both the inflow and outflow of the capital have become more volatile since 2000, synchronizing with the intensive adjustment of the NASDAQ market.

Responding to the rising capital flow, the Korean stock market has started to be influenced heavily by foreign investors. Table 2, which shows the Korea Stock Price Index (KOSPI) and the trends of capital flows,

makes clear that until the third quarter of 1998, the inflow and index did not correlate with each other: Until then there had been controls over the foreign investors' ownership, and the gap was bigger between the inflow and the index. However, since then, the index has moved more closely with the inflow of foreign capital. Importantly, there was a shock in the bond market in the summer of 1998 due to the collapse of the Daewoo group, the second largest chaebol in terms of assets. Since then the portfolio market as a whole has become much more volatile, while the panicky behavior of mutual funds paralyzed the bond market. As the psychological uncertainty dominated, the portfolio market started to be more influenced by short-term transactions both by foreign investors as well as domestic personal speculators. Being a typical emerging market, the Korean market is crucially lacking in long-term oriented, well-functioning institutional investors,³ as well as basic market infrastructure

Table 2 Stock Price Index and Capital Flow



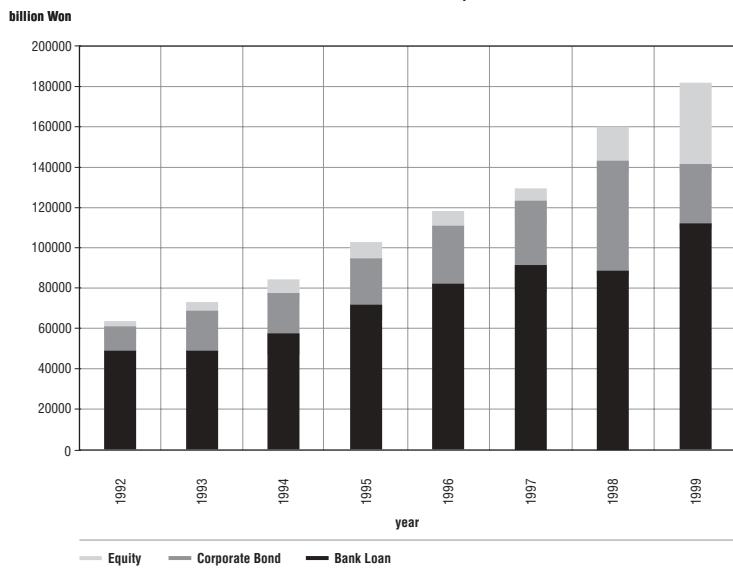
3 For the role of institutional investors, see Choi (1997), or Fukagawa (2000).

| | FDI | PFI | Asset | Debit | | FDI | PFI | Asset | Debit | |
|---------|-------|---------|--------|---------|--|---------|--------|---------|---------|---------|
| 1996.1 | 191.2 | -5.1 | -193.5 | 188.4 | | 1998.7 | 1007.2 | -668.2 | 200.8 | -869.0 |
| 1996.2 | 93.5 | 642.0 | -377.5 | 1019.5 | | 1998.8 | 654.4 | -1384.0 | 144.3 | -1528.3 |
| 1996.3 | 120.7 | 1502.7 | -337.5 | 1840.2 | | 1998.9 | 500.1 | -1825.3 | -429.7 | -1395.6 |
| 1996.4 | 144.2 | 2313.5 | -317.9 | 2631.4 | | 1998.10 | 732.6 | -690.2 | -336.2 | -354.0 |
| 1996.5 | 175.6 | 1539.1 | -356.8 | 1895.9 | | 1998.11 | 409.6 | -357.9 | -566.6 | 208.7 |
| 1996.6 | 360.1 | 1906.2 | -140.1 | 2046.3 | | 1998.12 | 437.1 | -1326.2 | -647.6 | -678.6 |
| 1996.7 | 45.0 | 1371.8 | -396.3 | 1768.1 | | 1999.1 | 560.2 | 1082.8 | -224.0 | 1306.8 |
| 1996.8 | 98.7 | 999.0 | -881.7 | 1880.7 | | 1999.2 | 364.0 | 198.2 | -216.7 | 414.9 |
| 1996.9 | 111.9 | 881.5 | -632.9 | 1514.4 | | 1999.3 | 502.2 | -396.1 | 127.3 | -523.4 |
| 1996.10 | 177.0 | 987.1 | -870.0 | 1857.1 | | 1999.4 | 684.5 | 2428.9 | -55.7 | 2484.6 |
| 1996.11 | 223.4 | 1705.9 | -923.6 | 2629.5 | | 1999.5 | 415.9 | 2015.6 | 125.8 | 1889.8 |
| 1996.12 | 584.1 | 1340.9 | -570.6 | 1911.5 | | 1999.6 | 709.8 | -395.5 | 165.4 | -560.9 |
| 1997.1 | 24.1 | 518.3 | -271.6 | 789.9 | | 1999.7 | 521.9 | -1.6 | 96.5 | -98.1 |
| 1997.2 | 401.6 | 340.4 | -473.0 | 813.4 | | 1999.8 | 1900.9 | -1736.9 | 229.9 | -1966.8 |
| 1997.3 | 198.3 | 1735.9 | 436.3 | 1299.6 | | 1999.9 | 307.7 | 565.4 | 771.7 | -206.3 |
| 1997.4 | 348.9 | 767.1 | -207.5 | 974.6 | | 1999.10 | 357.9 | 980.4 | 184.6 | 795.8 |
| 1997.5 | 190.9 | 2045.0 | -23.7 | 2068.7 | | 1999.11 | 1219.3 | 2159.3 | 325.4 | 1833.9 |
| 1997.6 | 250.7 | 3016.5 | -46.8 | 3063.3 | | 1999.12 | 1789.1 | 1775.9 | 153.1 | 1622.8 |
| 1997.7 | 312.3 | 2695.4 | -173.8 | 2869.2 | | 2000.1 | 658.0 | 1030.3 | 101.6 | 928.7 |
| 1997.8 | 255.7 | 799.0 | 55.9 | 743.1 | | 2000.2 | 310.9 | 2110.5 | -159.1 | 2269.6 |
| 1997.9 | 42.8 | 1949.5 | 198.3 | 1751.2 | | 2000.3 | 357.5 | 3608.7 | -1467.0 | 5075.7 |
| 1997.10 | 145.6 | 413.7 | -301.1 | 714.8 | | 2000.4 | 736.8 | 2189.2 | 1243.0 | 946.2 |
| 1997.11 | 286.3 | -815.1 | 747.2 | -1562.3 | | 2000.5 | 1505.4 | -1052.2 | -48.7 | -1003.5 |
| 1997.12 | 387.0 | 829.6 | 2067.9 | -1238.3 | | 2000.6 | 516.0 | 480.8 | -1259.1 | 1739.9 |
| 1998.1 | 113.7 | 370.6 | 335.3 | 35.3 | | 2000.7 | 1512.0 | 2171.8 | 1184.7 | 987.1 |
| 1998.2 | 207.5 | 2169.8 | 316.2 | 1853.6 | | 2000.8 | -125.1 | 1454.1 | 346.8 | 1107.3 |
| 1998.3 | 184.0 | 1265.5 | 562.9 | 702.6 | | 2000.9 | — | — | — | — |
| 1998.4 | 194.3 | 3667.7 | 52.4 | 3615.3 | | 2000.10 | — | — | — | — |
| 1998.5 | 508.2 | -1200.0 | -692.8 | -507.2 | | 2000.11 | — | — | — | — |
| 1998.6 | 463.6 | -1900.0 | -525.7 | -1374.3 | | 2000.12 | — | — | — | — |

including transparent accounting and fair investor relations. As a result, the market has been characterized by speculative transactions by those who shared the fear that they might be less informed than chaebol-related firms or other investors. The market has shown extremely nervous responses to the North-South dialogue development since 2000.

Changed corporate finance and KOSDAQ-lead growth. Even though the equity/bond markets have turned out to be less mature, rapid restructuring in the financial sector has caused intensive financial shrinkage, starting from the money-centered banks. As the banks underwent restructuring, pressed strongly by the government, and bank interest rates were withdrawn in consultation with the IMF since the latter half of 1998, domestic capital moved from the banking sector into the equity/bond market, expecting improved performance by firms. Therefore, the five largest chaebols, later four largest after the bankruptcy of Daewoo, could allocate the capital in the market. Table 3 indicates the bond boom in 1998 taken over by equity finance in 1999. As was confirmed in Table 2, a market hike encouraged more capital to flow into the market pushing up the index again for the expansionary cycle. The market enjoyed a boom from 1999 until the first half of 2000.

Table 3 Structure of Corporate Finance



Corporate Finance in change

| | Bank Loan | Corporate Bond | Equity | Total | | Bank Loan | Corporate Bond | Equity | Total |
|------|--------------|-------------------|--------|--------|------|--------------|-------------------|--------|--------|
| 1992 | 54527 | 11154 | 2349 | 68030 | 1996 | 85141 | 29903 | 5285 | 120329 |
| 1993 | 55060 | 15599 | 3258 | 73917 | 1997 | 94296 | 34321 | 3389 | 132006 |
| 1994 | 61832 | 20049 | 6247 | 88128 | 1998 | 92851 | 55998 | 14158 | 163007 |
| 1995 | 74871 | 23598 | 6266 | 104735 | 1999 | 112869 | 30670 | 41113 | 184652 |

ROK's Trade with China

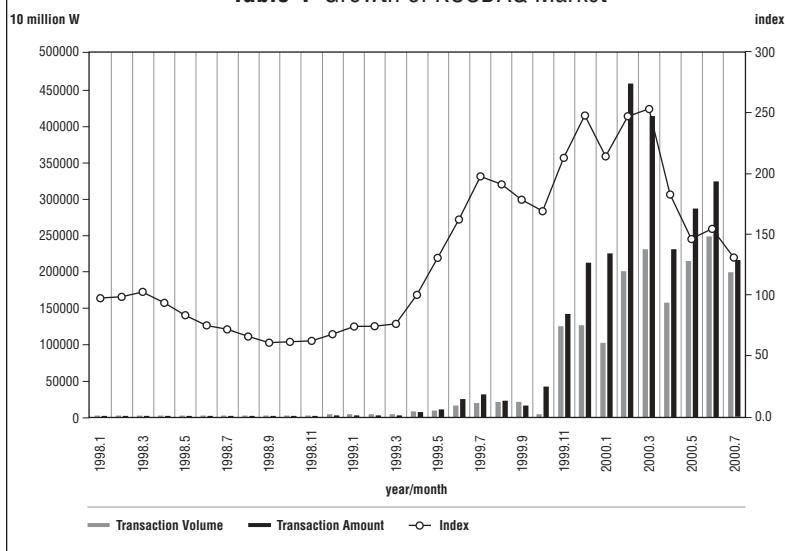
| | Import from C | Import from J | Import from USA | Others | Total | | Import from C | Export to C |
|------|------------------|------------------|--------------------|---------|----------|------|------------------|----------------|
| 1991 | 3440.5 | 21120.9 | 18894.4 | 38069.1 | 81524.9 | 1991 | 3440.5 | 1002.5 |
| 1992 | 3724.9 | 19457.7 | 18287.3 | 40305.4 | 81775.3 | 1992 | 3724.9 | 2653.6 |
| 1993 | 3982.7 | 20015.5 | 17928.2 | 41873.7 | 83800.1 | 1993 | 3982.7 | 5151 |
| 1994 | 5462.8 | 25390 | 21578.8 | 49916.6 | 102348.2 | 1994 | 5462.8 | 6203 |
| 1995 | 7401.2 | 32606.4 | 30403.5 | 64707.8 | 135118.9 | 1995 | 7401.2 | 9143.6 |
| 1996 | 8538.6 | 31448.6 | 33305.5 | 77046.4 | 150339.1 | 1996 | 8538.6 | 11377.1 |
| 1997 | 10116.9 | 27907.1 | 29981.2 | 76611.2 | 144616.4 | 1997 | 10116.9 | 13572.5 |
| 1998 | 6484 | 16840.4 | 20403.2 | 49554.2 | 93281.8 | 1998 | 6484 | 11944 |
| 1999 | 8866.7 | 24142 | 24922.3 | 61821.3 | 119752.3 | 1999 | 8866.7 | 13684.6 |

| | Export to C | Export to J | Export to USA | Others | Total |
|------|----------------|----------------|------------------|---------|----------|
| 1991 | 1002.5 | 12355.8 | 18559.3 | 39952.5 | 71870.1 |
| 1992 | 2653.6 | 11599.5 | 18090 | 44288.1 | 76631.2 |
| 1993 | 5151 | 11564.4 | 18137.6 | 47382.6 | 82235.6 |
| 1994 | 6203 | 13522.9 | 20552.8 | 55734.5 | 96013.2 |
| 1995 | 9143.6 | 17048.9 | 24131.5 | 74734 | 125058.0 |
| 1996 | 11377.1 | 15766.8 | 21670.5 | 80900.7 | 129715.1 |
| 1997 | 13572.5 | 14771.2 | 21625.4 | 86195.1 | 136164.2 |
| 1998 | 11944 | 12237.6 | 22805.1 | 85326.4 | 132313.1 |
| 1999 | 13684.6 | 15862.5 | 29474.7 | 84663.3 | 143685.1 |

| | FDI to China | Others | Total | FDI |
|------|--------------|--------|-------|------|
| 1990 | 55 | 903 | 958 | 39 |
| 1991 | 85 | 1030 | 1115 | 112 |
| 1992 | 221 | 998 | 1219 | 269 |
| 1993 | 622 | 639 | 1261 | 629 |
| 1994 | 821 | 1479 | 2300 | 1066 |
| 1995 | 1240 | 1831 | 3071 | 878 |
| 1996 | 1627 | 2657 | 4284 | 911 |
| 1997 | 895 | 2335 | 3230 | 732 |
| 1998 | 805 | 3088 | 3893 | 290 |

Another stimulating factor came from the KOSDAQ market being pushed by booming venture firms. As Table 4 shows the venture business boom reached its peak at the beginning of 2000 until the market was seriously affected by the NASDAQ adjustment in April. Before the collapse, the capital, which could not be absorbed fully by the corporate bonds of large chaebols, spilled over into venture capital. It was notable that unlike Japan, where potential entrepreneurs are still contained in the big, established firms, Korean venture firms could find fresh human capital through the intensive restructuring of chaebol-related firms. Thanks to the excellent Internet infrastructure in broadband, Korea's venture capital flourished in IT-related businesses. It was fortunate for Korea to find a way to go back to the growth track through the IT boom backed by KOSDAQ capital. Since the summer of 2000, however, the boom became a bust, but the boom experience has encouraged small firms to seek equity financing. While the market itself remains volatile, corporate finance has had to shift from indirect finance to direct capital allocation, sensitively assessing the

Table 4 Growth of KOSDAQ Market



KOSDAQ development

| | 10 million W | | million W | | |
|---------|--------------------|--------------------|-----------|--------------------|----------|
| | Transaction Volume | Transaction Amount | Index | Transaction Amount | Index |
| 1998.1 | 345 | 586.4 | 98.4 | 5,864 | 586.4 |
| 1998.2 | 413 | 722.1 | 99.3 | 7,221 | 722.1 |
| 1998.3 | 336 | 970.1 | 103.8 | 9,701 | 970.1 |
| 1998.4 | 159 | 269.6 | 95.1 | 2,696 | 269.6 |
| 1998.5 | 186 | 207.4 | 84.6 | 2,074 | 207.4 |
| 1998.6 | 581 | 807 | 76.5 | 8,070 | 807 |
| 1998.7 | 467 | 246.7 | 72.7 | 2,467 | 246.7 |
| 1998.8 | 480 | 175.1 | 66.7 | 1,751 | 175.1 |
| 1998.9 | 456 | 328.9 | 61.4 | 3,289 | 328.9 |
| 1998.10 | 828 | 424.6 | 62.2 | 4,246 | 424.6 |
| 1998.11 | 1,787 | 674 | 63.2 | 6,742 | 674.2 |
| 1998.12 | 2,793 | 1,386 | 68.7 | 13,862 | 1386.2 |
| 1999.1 | 3,215 | 1,648 | 75 | 16,477 | 1647.7 |
| 1999.2 | 3,774 | 1,690 | 75.1 | 16,895 | 1689.5 |
| 1999.3 | 3,507 | 1,615 | 76.9 | 16,154 | 1615.4 |
| 1999.4 | 7,726 | 6,425 | 101 | 64,247 | 6424.7 |
| 1999.5 | 8,179 | 10,203 | 131.3 | 102,026 | 10202.6 |
| 1999.6 | 14,976 | 23,217 | 162.9 | 232,168 | 23216.8 |
| 1999.7 | 18,411 | 30,270 | 198.6 | 302,700 | 30270 |
| 1999.8 | 20,795 | 21,708 | 192.3 | 217,080 | 21708 |
| 1999.9 | 19,421 | 15,306 | 179.3 | 153,058 | 15305.8 |
| 1999.10 | 3,070 | 40,952 | 169.5 | 409,523 | 40952.3 |
| 1999.11 | 124,500 | 140,947 | 213.3 | 1,409,474 | 140947.4 |
| 1999.12 | 125,150 | 211,113 | 247.8 | 2,111,125 | 211112.5 |
| 2000.1 | 101,100 | 223,950 | 214.6 | 2,239,500 | 223950 |
| 2000.2 | 199,700 | 457,560 | 247.1 | 4,575,600 | 457560 |
| 2000.3 | 229,454 | 411,191 | 252.8 | 4,111,909 | 411190.9 |
| 2000.4 | 155,777 | 229,500 | 182.8 | 2,295,000 | 229500 |
| 2000.5 | 213,000 | 285,350 | 146.2 | 2,853,500 | 285350 |
| 2000.6 | 247,000 | 322,473 | 154.6 | 3,224,730 | 322473 |
| 2000.7 | 197,300 | 214,200 | 130.7 | 2,142,000 | 214200 |

North Korean business of some companies such as Hyundai. The political influence from the North affects not only the capital movement, but will directly influence the South Korean real sector through market discipline.

Implications for the South-North relations. Drastically increased capital inflows and outflows are expected to grow further after the portfolio investment by Korean residents is completely liberalized in 2000. Unlike the times when corporate finance was heavily dependent on implicitly long-term bank lending instead of direct financing, the increasing scale of capital transactions will have a greater impact on the Korean economy. For instance, the capital inflow into the equity market was only 2.4 percent of Korean GDP in 1996, but it grew to 10.7 percent in 1999. At the same time, the outflow was also only 1.4 percent in 1996, but it reached 9.3 percent in 1999.

If there were to be some serious political tensions with the North and Korean residents' capital left based on the 1996 scale, it would reach 10.8 percent of Korean GDP. Since 1996 was a year when the economy was in a normal state but the capital transactions were still under strict controls, this figure can be considered as the modest scenario. Now, after the crisis, Korean non-performing debt is estimated at almost 40 percent of its GDP. 10.8 percent of sudden capital outflow with no inflow would create an extreme shock to the economy, and an absolute condition for the stable performance of the Korean economy is to prevent massive capital flight resulting from political tensions. This may imply that the North can threaten the South effectively enough by creating political, especially security, pressure without developing any costly weapons.

Even if capital flight did not occur, or emergency controls could prevent capital flight, a critical security threat will be able to cause fatal damage to the South Korean economy through a crash in the equity market. Without any threat from the North, the equity market will remain vulnerable, partly because financial restructuring is still going on, and partly because of the structural weakness mentioned. In addition, recently intensive electronic transactions have contributed to the short-term transactions. Now, in South Korea, 50-80 percent of market transactions is estimated to be through the Internet or even hand phones. This is probably the highest ratio in the world. In a financial panic, ironically, advanced IT has contributed to encouraging short-term transactions. During the

transition period when the banks cannot provide enough loans to firms, direct finance is expected to play a complementary role, while providing an engine for the new economy in South Korea. However, this also means that any kind of financial panic in the market will be fatal to the economy. Therefore, the first reality is that peace with the North has turned out to be essential following the implementation of structural adjustment policies for the South.

Growing-Out-the-Debt and Survival Strategy

Soaring budgetary deficit. Even in the midterm, there is another reason why South Korea needs the North; the soaring pressure on the government budget. Traditionally, South Korea had maintained a conservative budgetary policy, and the deficit used to be almost negligible. However, after the intensive injection of public capital into the restructured banks and other financial institutions, the budgetary deficit grew to W18.8 trillion in 1998 and 13.1 trillion in 1999 by consolidated basis, or 3.2 percent of GDP, compared to a W1.1 trillion surplus in 1996. Thanks to the robust recovery, the deficit turned to surplus of W5.6 trillion again in 2000. However, as more capital is needed to restructure the Daewoo group, some of the Hyundai subsidiaries and many other non-viable firms as well as banks, the government has decided to commit another W49 trillion already in 2000, which consists of W149 trillion of public money as the accumulated basis. The outstanding of national bond issuance has almost tripled from 1996 to W71.2 trillion in 2000, and with the sharp downturn of the economy in 2001, downside risk has increased again to focus on the budget. Unless the non-performing loans are miraculously liquidated while capital inflow continues, there can be an interest hike by the crowding-out effect of national bonds steadily. The Korean economy will have to struggle with this soaring budgetary deficit at least for the midterm, and obviously there will less and less room for integration if the North collapses.

Growing-out-the-debt and survival strategy. Therefore, besides restructuring, Korea will have to find a strategy to grow out of debt, while surviving in the competition with both Japan and China in the mid to long-term. A positive aspect is that North Korean labor if successfully mobilized is anticipated to mitigate a South Korean labor shortage, especially in “old economy” sectors. The average wage dropped by 9.3 percent in 1998 in the South, but in 1999 it went up by 11.1 percent and there were even some large-scale labor disputes.⁴ On the other hand, there already have been OEM-based transactions with the North, and the South has been impressed with the disciplined, cheap labor. Demographically, the South Korean structure is still much younger than Japan, enjoying more than 70 percent of the working population. However, already, a recent sharp decline in birth rate and very strong demand for higher education has made it difficult to find enough labor in manufacturing and construction. If international division of labor can be established smoothly with the North, the South Korean old economy will be able to enjoy substantial cost reduction in construction, heavy industries, marine transportation, and other sectors, which in fact, the North has accumulated certain experience.

In addition to the division of labor, another positive aspect for the Korean economy is to make it the center or to enhance its hub function in the Northeast Asian region. This is symbolized by the railroad connection between the North and the South. The so-called Euro Land Bridge from China to Europe was completed in 1990; specifically, it connects the ports of Renun, Shanghai, Qingdao, and Tianjin with the Netherlands via Moscow. The idea in South Korea is to connect the railroad from Pusan and other ports with this bridge so that South Korea will be able to improve its economic structure by enhancing its hub function as in Singapore. Korea has also shown a strong interest in regional energy development, as well as being an IT hub by developing B2B and B2C sites. In fact, since the big earthquake in Kobe, Pusan port has turned to make itself a major substitute in the region. And a sign of Korean ambitions.

4 For instance, Daewoo Motors had to declare default due to the labor union, which rejected the restructuring plan of reducing the number of employees in 2000.

Implications for South-North relations. The reality of South Korean hub strategy depends on the economic linkages in the region. So far, among the world's hundred largest economies, only Japan, China, Taiwan, Hong Kong, and South and North Korea have not joined any regional cooperation framework.⁵ The political wall has been traditionally high, being reinforced by deeply rooted mutual distrust in Northeast Asia. Even in the early 1990s, when the boom of regional economic integration started in Asia, including Southern China-Hong Kong/Taiwan, Thailand-Vietnam/Laos, and the China-Russian border, economic exchange in this region has been marginal, partly due to the existence of the most closed economy of the DPRK. For instance, despite its potential, intensively studied by the UNDP, a project to develop the area around the Tumen River has not seen any crucial progress in the last decade.

However, once a change in the DPRK starts, even slowly, and the momentum for regional cooperation emerges, the South Korean economy will potentially reap much benefit for various reasons. First, having integration in mind, the ROK has been constantly positive about cooperation since the 1990s. But now it has even more incentive and need for cooperation given its severe budgetary constraints in the midterm. In the South Korean point of view, a sudden collapse of the North has to be deterred by any means, because if it happens at present, the ROK's support can only be very limited, and this may allow other regional powers to play a more important role as in history. On the other hand, if this economic constraint in the South reduces North Korean fears that they would be absorbed immediately, it may provide the North with a rational motive for cooperation.

Secondly, to find a breakthrough to go back to the economic growth track, the South desperately needs a clear and strategic blueprint. Until the crisis, South Korea followed the changes of Japanese industrial structure and this strategy has been safe in securing a position in the world market by exporting goods slightly cheaper than Japan. This strategy had been

5 Japan started negotiations with Singapore, while the ROK has sought ties with Chile.

preconditioned on the assumption that Japan would keep growing and advancing its industrial structure constantly, providing more room for Korean export growth. This strategy had to end when Japan stopped growing, and indeed South Korea went into a crisis with Japan's fall in 1997.

If cooperation with the North is realized, South Korea's "old economy" will be able to depend on less costly Northern labor, while also helping the North. Also, once the North opts to enter international society and succeeds in getting support from international organizations as well as Japan, the North Korean market could be a frontier for the South's business, such as construction and engineering, heavy and chemical industries, and probably some consumer goods.⁶

Finally, if North Korea agrees to share the advantage, the strategic location of the Korean Peninsula could be projected. It has access to the Euro Land Bridge as well as a connection with Russia to establish a business center for various industries in the region, such as transportation and distribution, energy, business supports, tourism, R&D activities, and probably even IT. Needless to say, the "business center strategy" cannot be developed or sustained with political tension in the region. If South Korea seeks this strategy, the success will be highly dependent on the stability in the North. However, on the other hand, the very structure itself may bring better stability, not only because the South and the North would share a common interest, but also because mutual dependence might change the bilateral balance, and alleviate North Korea's contained feelings and hence any desperate behavior. The users and customers of a Korean business center will oppose political friction in the peninsula. The second economic reality is that the South needs the regional integration in the mid to long-term, which can enhance political stabilization.

6 Before the summit in 2000, President Kim Dae Jung repeatedly referred to the possible frontier market after economic exchange with the North.

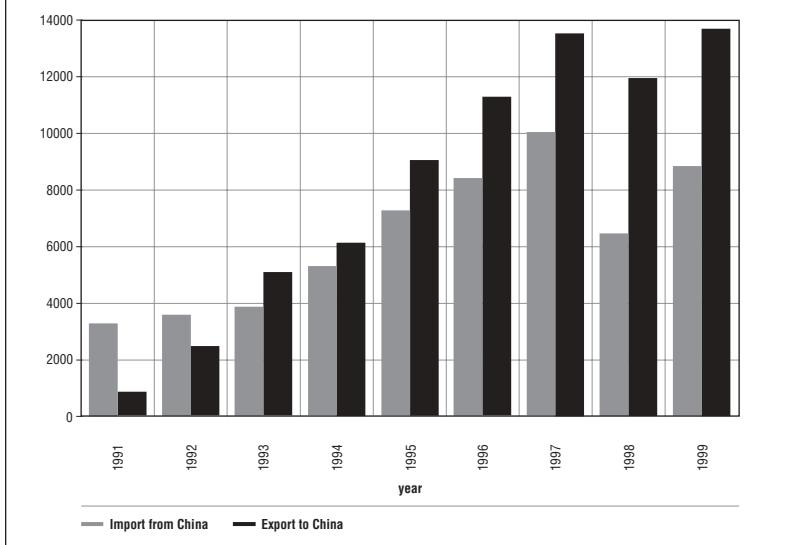
Greater presence of China

Expanding economic exchange between China and the ROK. A final factor in the wake of the East Asian financial crisis is the growing presence of China. Fortunately, China was not affected directly, partly due to its closed capital market and strong foreign exchange control. While most of its competitors have suffered from a financial shrinkage, even when the depreciated exchange rate brought better export potential, China could recover faster, because of its huge domestic demand. With its entrance into the World Trade Organization (WTO) regime, China's economic presence will become even more prominent.

China's growing presence, in contrast with Japan's sunset, has started to change the balance in the region. After the financial crisis, South Korea has actually paid more business attention to China than to the United States or Japan, her old allies.⁷ Although under the Kim Dae Jung regime, Japan-South Korea relations have improved dramatically, there remains the memory in South Korea that the financial panic started with Japan.⁸ Moreover, with the lifting of import controls against Japanese products, imports have started to increase rapidly enough since 1999 to raise traditional fears that the economy will be dominated and affected by Japan again. On the other hand, the restructuring process lead by market capitalism has encountered emotional resistance in the domestic market, especially from labor unions. Even before the crisis, South Korea had trade frictions with the United States on automobiles, steel, and other major export items, which interpreted the financial crisis as sanctions for the friction.

7 Many opinion polls after the crisis supported the greater presence by China in the 21st century in South Korea.

8 In South Korea, many believe that the financial crisis was triggered by intensive capital withdrawal by Japanese financial institutions.

Table 5 ROK's Trade with China

Unlike the United States or Japan, South Korea's economic ties with China have been growing impressively fast, and with less friction so far.⁹ As noted in Table 5, South Korean trade with China has been accelerated in only eight years since the diplomatic ties were established. It is notable that exports dropped only a little in 1998 when the economy was undergoing severe restructuring, while imports are lagging due to shrinkage in Korean demand. As result shown in Table 6-A to 6-B, the Chinese market share for South Korean exports has grown, substituting for the stagnant Japanese, as well as the stable American market. Presence in imports is much more limited among Japan and the United States, implying that South Korea's stable trade surplus with China is in contrast with those matured markets.

9 In 2000, China stopped import of petrochemical products and hand phones from the ROK in revenge for South Korean measures to restrict garlic imports from China. This was virtually the first severe friction with China, but it settled down in a relatively short period.

Table 6-A ROK's Export Structure

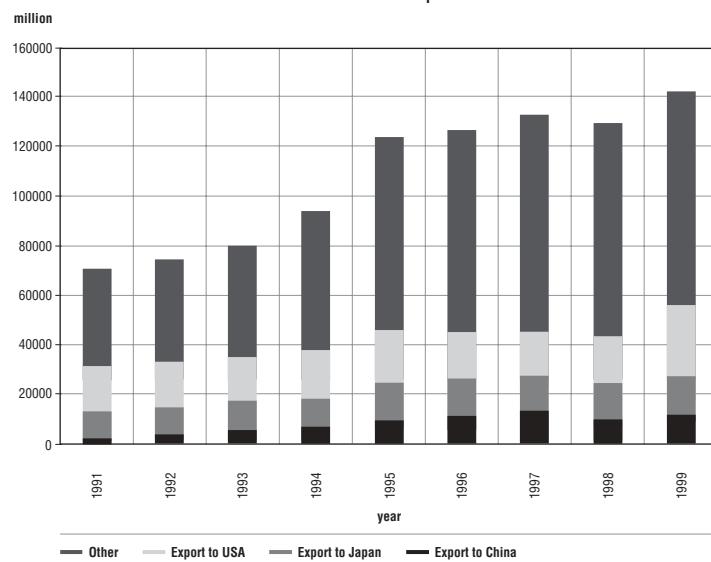


Table 6-B ROK's Import Structure

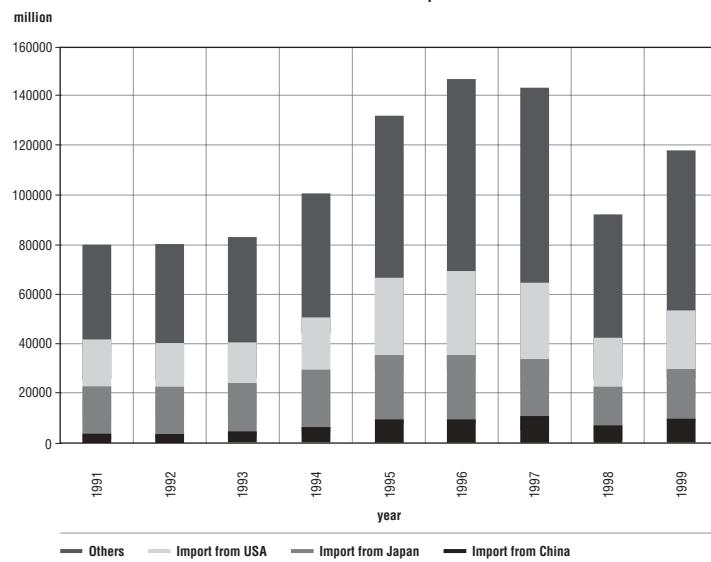
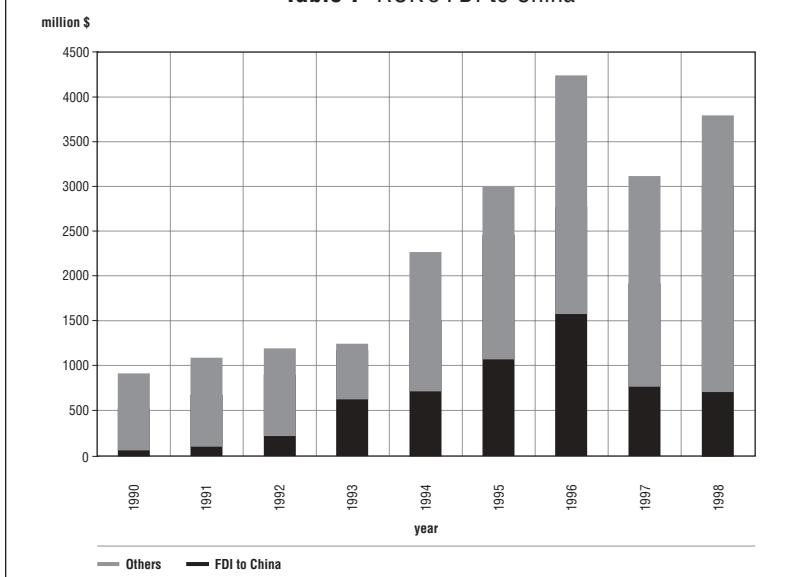


Table 7 ROK's FDI to China

More importantly, South Korean foreign direct investment (FDI) to China, following trade, has grown very rapidly as in Table 7. In total amount, nearly 20-30 percent of Korean investment has gone to China, but in a number of cases in accumulated FDI by South Korea, as much as 45 percent is concentrated in China by small companies mostly in labor-intensive industries. Recently, in discussions about a Free Trade Agreement with Japan, South Korea has insisted on inviting China into the arrangement, perplexing Tokyo.

Echoing models. China has traditionally shared an interest in the stability of the peninsula. It especially pays close attention to the ethnic Korean Chinese at the border. It will be natural for the DPRK, which has maintained a connection with China, to seek practical advice when it really starts to reform and open, even in any kind of limited form. China will be happy to share its own experience by increasing its intellectual influence in the DPRK. The existence of the DPRK as a buffer between

the ROK will be appreciated by China, so that it can share its experience of gradual economic reform without democratization.

However, with the start of dialogue between the South and the North, there will be another experience that China will share: The increase of mutual economic dependence between Taiwan and China, which has been a tacit deterrent for the security problem. Taiwanese FDI and the resulting industrial concentration have strongly supported China's industrial capacity especially in electronic devices and IT-related manufacturing. Taiwanese high-tech industries have also enjoyed a positive productivity and cost reduction effect in the mainland given its own labor shortage. Not only is North Korea trying to learn from China, but South Korea may also try to learn from this experience. And if the South does so, the influence of China will be greater. Based on this precedent model, North Korea can maintain special relations with the South, while expanding normal official ties with Western countries, and the South will gain more time for restructuring. There is an open question of whether the two Koreas can be independent from the complicated politics, and can be practical like the Chinese. But the echoing between China-Taiwan relations and South-North relations may at least contribute to bringing the peninsula closer to China.

Implications for South-North relations. Even if the economic presence of China is positive to both South Korea and North Korea, there will be a constraint for the DPRK to copy the Chinese-type of gradual reform, given the minor scale of the domestic market. As a resource-poor country, the DPRK desperately needs to expand exports, while China could benefit by agricultural reform leading to a larger domestic market. In fact, China will be able to provide its huge market to the DPRK, especially after China becomes a WTO member. In the early stages, there are many things for the DPRK to learn to be competitive in the external market, and China, with its various consumption levels unlike the ROK and Japan, may serve as a better market in which the DPRK can practice. When South Korean FDI serves as the engine for the North Korean exports, the potential of the Chinese market will be even more attractive. For instance, in textile industries China already has upgraded its supporting industries, and the

North will be highly dependent on material and parts imports from China in the early stages. In the past, the North has been supported by China mainly through food and energy inputs, but after the “reform” and opening starts, intellectual dependence on China will be greater, which has accumulated practical experience and information.

The absorptive power of the Chinese market will be more direct for South Korea. Although China is catching up very rapidly, there will be complementarity in areas such as telecom devices, automobiles, and other heavy and chemical products. Above all, in choosing a technological standard, China will have a greater impact on the ROK with its bargaining. In IMT-2000, the next generation mobile phone, South Korea focused on the cdma-one standard, but only when China decided to adopt W-cdma with Japan and Europe also, the ROK had to switch to the same decision because of the market dependence on China. Even as the ROK tries to make itself the business hub of Northeast Asia, its function and success will be highly dependent on consumers, mostly Chinese and Japanese. Not only in trade and FDI, but also in technology standards, in infrastructure building, or in tourism and other services trade, China will be critical for the South too.

China, holding the cards for both the North and the South in terms of economic cooperation and intellectual support, will be more influential in the South-North dialogue. China will be able to keep the influence on both, in accordance with its national interests. The third reality then, is that although the Chinese have been relatively modest about their role in the dialogue, in addition to the geographical grounds for being involved in the issue, China has successfully acquired these economic cards.

Conclusion

Although some people expect possible dramatic changes of policy by the North as well as by the South, the options for South Korea seem to be limited, at least from an economic point of view. After the IMF reform, the

capital market was totally opened with the potential risk of capital flight. At the same time, the shift of corporate finance from indirect to direct financing has created a more vulnerable structure on the economy through the possible excessive response by the market from an unpredictable political threat. On the other hand, since huge public spending has been committed to restructuring the financial as well as corporate sector, the growing-out strategy is very much needed, including a center/hub function in the Northeast region by the South. In this context, the Chinese presence will inevitably grow by offering its markets for both the South and the North. In addition, since China has the experience of reform to offer the North, and the experience of economic interdependence with Taiwan for the South, its role will not be limited to being a market provider, but will expand and deepen into being the intellectual supporter for the North-South dialogue.

When President Kim Dae Jung came back from the DPRK after his historical visit, he proudly declared that the time had come when the destiny of the peninsula would not be manipulated by the conflicts of surrounding superpowers. However, intensive market opening and globalization has started to pressure the South to follow the market response as well as closer relations with China, the largest geographical neighbor. Neither of these factors will be manipulated by South Korean domestic politics, and, in this sense, the situation is ironically similar to North Korea, which has taken the risk of uncontrollable interface with international society. President Kim's visit might have kicked off the time when two hermit kingdoms challenge globalization sharing their goal of integration.



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